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IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 10058

OTIS & COMPANY, *Appellant,*

v.

SECURITIES & EXCHANGE COMMISSION, EDMUND M. HANRAHAN, ROBERT K. McCONNAUGHEY, RICHARD B. McENTIRE, HARRY A. McDONALD AND PAUL R. ROWEN, *Appellees.*

Appeal from the United States District Court for the District of Columbia

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JOINT APPENDIX.

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1 Filed Nov 10 1948

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

No. 4613-'48

OTIS & Co., 2000 Terminal Tower, Cleveland, Ohio, *Plaintiff*,

v.

SECURITIES AND EXCHANGE COMMISSION, EDMOND M. HANRAHAN, ROBERT K. McCONNAUGHEY, RICHARD B. McENTIRE, HARRY A. McDONALD and PAUL R. ROWEN, *Defendants.*

Complaint—Injunction

Plaintiff by its attorneys, complaining of the defendants, alleges that:

1. Plaintiff is a corporation organized and existing under the laws of the State of Delaware and is one of the leading investment bankers of the United States with a long and outstanding record in the distribution of investment securities on a nationwide scale. Its principal offiices are at 2000 Terminal Tower, Cleveland, Ohio.

2. The defendant Securities and Exchange Commission is a governmental agency created and deriving its powers under Section 4 of the Securities Exchange Act of 1934, 15 USC § 78d. Its offices are at 425 2nd Street, N. W., Washington, D. C.

3. The individual defendants are individuals found doing business and officially resident within the District of Columbia at 425 2nd Street, N. W., Washington, D. C., and are the members of the said Securities and Exchange
2 Commission under whose direction and supervision the acts hereinafter alleged with respect to it have occurred; that defendant Rowen's participation began on May 28, 1948, when he took office.

4. The jurisdiction of this Court arises under Sections 11-305 and 11-306 of the District of Columbia Code and

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under 28 USC §§ 2201 and 2202 (formerly 28 USC § 400). Jurisdiction is also based on Section 10 of the Administrative Procedure Act, 5 USC § 1009.

5. Cyrus S. Eaton is and since 1912 has been a leading industrialist and banker, and he and his family together own a majority of the stock of plaintiff.

6. Kaiser-Frazer Corporation (hereinafter referred to as "Kaiser-Frazer") is a corporation organized and existing under the laws of the State of Nevada, engaged in the manufacture and sale of automobiles and parts thereof.

7. The National Association of Securities Dealers (hereinafter referred to as NASD) is a corporation organized under the laws of the State of Delaware which exercises powers vested in it pursuant to Section 15A of the Securities Exchange Act of 1934 (15 USC § 78o-3), subject to the general supervision of the Commission.

II.

8. Plaintiff underwrote and sold the initial issue of Kaiser-Frazer stock in September 1945, and thereafter, in January 1946, was one of the underwriters and sellers of a second issue of stock by Kaiser-Frazer.

9. On February 3, 1948, plaintiff entered into a contract by which plaintiff agreed, subject to various conditions, to participate in the underwriting of a third offering
3 of stock by Kaiser-Frazer.

10. Among the conditions precedent to plaintiff's obligation to purchase its share of the proposed stock offering pursuant to the underwriting contract were:

(a) That the registration statement filed with the Commission was truthful and accurate in all respects.

(b) That there had been no substantial adverse change in the condition, financial or otherwise, of Kaiser-Frazer since November 30, 1947.

(c) Proper legal opinions were obtained from Kaiser-Frazer counsel acceptable to underwriters' counsel.

11. Plaintiff terminated its commitment to purchase its portion of the stock because these conditions were not fulfilled in the following respects, among others:

(a) The registration statement contained false and misleading statements in material respects.

(b) The condition of Kaiser-Frazer had changed adversely since November 30, 1947.

(c) The legal opinions offered by Kaiser-Frazer counsel were unsatisfactory to underwriters' counsel.

(d) The market for the securities had been manipulated by Kaiser-Frazer and an offering would have been illegal.

(e) Signature to the agreement was induced by false representation by officials of Kaiser-Frazer.

12. Thereafter, on or about February 13 1948, Kaiser-Frazer filed an action in the Supreme Court of the State of New York against plaintiff for alleged breach of the underwriting contract. This action was thereafter removed to the United States District Court for the Southern District of New York, where it is presently pending, an answer having been filed and other proceedings having been had.

4 13. One of the major issues in the aforesaid action brought by Kaiser-Frazer is Kaiser-Frazer's charge that plaintiff, acting through Mr. Eaton, had caused one Masterson to file a stockholder's derivative suit on behalf of Kaiser-Frazer against the officers of that company and others to provide a basis for plaintiff's termination of the underwriting contract.

III.

14. At various times during the month of February, 1948, and thereafter, officials and agents of Kaiser-Frazer transmitted letters and memoranda to the Securities and Exchange Commission and to various of the defendant Commissioners and other officers and agents of the Commission, and also held numerous conversations with them, making unfounded and defamatory charges concerning plaintiff, and by various means the exact details of which are un-

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known to the plaintiff, successfully sought to induce the defendant Commission and individual Commissioners to commence and prosecute investigatory and punitive proceedings against the plaintiff.

15. On or about February 18, 1948, the Commission issued an order for a private investigation into the circumstances of said Kaiser-Frazer stock offering, a copy of which order is annexed hereto as Exhibit "A" and made a part hereof.

16. The normal termination of such a private investigation would have been a closing of the file if no violation of law was found or the institution of adversary proceedings if a violation of law was discovered. The Commission followed neither of these courses. Instead, the Commission proceeded on or about March 23, 1948, to issue an order for a so-called public investigation, a copy of which order is annexed hereto as Exhibit "B" and made a part hereof. Contrary to the practice in all other such investigations, plaintiff was denied an opportunity to cross-examine witnesses, or to adduce evidence in its own behalf, although it made various proffers of proof each of which was rejected by the Commission. Both by its manner of conducting the proceedings and by numerous releases to the press and conversations with reporters and financial writers, the defendants deliberately and improperly sought to and did inspire, instigate and create maximum prejudice and adverse publicity against plaintiff which have injured its business and reputation.

17. In the course of this so-called public investigation the Commission sought to compel attorneys for said Cyrus S. Eaton, to testify to confidential communications between the said attorneys and said client.

18. Upon the refusal of such attorneys to violate the attorney-client relationship as demanded, the Commission stated that the evidence in the record of its public investigation established a prima facie showing that the plaintiff, through said Eaton, had consulted such attorneys for the purpose of causing the Masterson suit to be filed, and

ordered said attorneys to testify concerning such communications, which they again declined to do.

19. Thereafter and on or about June 25, 1948, the Commission instituted an action in the District Court of the United States for the District of Columbia against two of said attorneys to compel such disclosure, in which action plaintiff and said Eaton intervened as parties. This action, entitled "Securities and Exchange Commission, plaintiff, v. Marvin C. Harrison and Allan Hull, defendants, #2617-48", is hereinafter referred to as "the S. E. C. action".

20. The complaint in the S. E. C. action alleged that the Commission had conducted an investigation into the circumstances surrounding the third offering of Kaiser-Frazer stock, that the defendants had declined to testify concerning their communications with Eaton on the ground of attorney-client privilege, that there is no privilege where there is a prima facie showing that the communications were made in connection with the perpetration of a fraud or other illegal act, and that the evidence in the record established a prima facie showing that Eaton had consulted the defendants in connection with the perpetration of a fraud involving the filing of a collusive lawsuit, to wit,, the Masterson suit. A copy of the Commission's complaint in the S. E. C. action is attached as Exhibit "C". In support thereof the Commission offered in evidence the entire record of its public investigation consisting of more than 5000 pages of testimony and more than 600 exhibits taken in hearings held in eight cities during a period of more than three months. Defendants and intervenors denied that the evidence in the record established a prima facie showing as alleged by the Commission.

21. While the S. E. C. action was pending before this Court and before the submission of final briefs by counsel, and on or about August 11, 1948, the Commission instituted a further proceeding against plaintiff by an order and notice, a copy of which is hereto annexed as Exhibit "D" and made a part hereof, for the stated purpose of determining whether

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the registration of Otis & Co. as a broker and dealer and its membership in the NASD should be revoked or suspended, thereby making it impossible for Otis & Co. to conduct its business. The principal charge therein was
that "as the result of . . . [its] public invetiga-
7 tion" the Commission had obtained information "which tends, if true, to show that" plaintiff Otis & Co. caused the Masterson suit against Kaiser-Frazer to be filed for the purpose of evading its obligations under the underwriting agreement.

22. Plaintiff herein requested the Commission to delay proceedings under the aforesaid order and notice, Exhibit "D", until after the determination by the District Court of the issues in the S. E. C. action. Upon the Commission's refusal so to do, plaintiff applied to the District Court and obtained an injunction directing the Commission to withhold any action in pursuance of the said notice and order Exhibit "D" pending the decision by the District Court of the S. E. C. action upon the ground that the matters and issues "under consideration by Judge Morris in *Securities and Exchange Commission* v. *Harrison, et al.*, No. 2617-48, will arise in the proceedings ordered by the S. E. C. in its order of August 11, 1948." Copies of the memorandum of the District Court upon such application and of the findings and order thereon are hereto annexed, marked Exhibits "E" and "F" respectively, and made a part hereof.

23. The Comission filed a notice of appeal from the aforesaid order and announced that it would seek to expedite said appeal but it took no action to prosecute said appeal until after the S. E. C. action was decided by Judge Morris, when the Commission docketed the record in the Court of Appeals and also filed a motion that the order of Judge Letts, being Exhibit "F" hereof, be reversed as moot, which motion will be opposed by plaintiff herein.

24. On October 18, 1948, Judge Morris filed an opinion on the issues in the S. E. C. action, which opinion was
8 subsequently designated as the Court's findings of fact and conclusions of law therein, a copy of which

is hereto annexed as Exhibit "G" and made a part hereof. On October 28, 1948 Judge Morris entered judgment pursuant thereto; a copy of said judgment is hereto attached, marked Exhibit "H" and made a part hereof.

25. Said judgment denies the relief prayed for by the Commission in its complaint upon the sole ground that the evidence submitted by the Commission in support thereof, to wit, the record of its public investigation, does not make a prima facie showing that the Masterson suit was inspired, as had been claimed by the Commission.

26. The Commission has not appealed from the said judgment and upon information and belief does not intend to appeal therefrom. However, immediately upon the entry of the said judgment, the Commission issued an order, a copy of which is attached hereto marked Exhibit "I" and made a part hereof, directing that the hearing pursuant to its order of August 11, 1948, should proceed.

27. In said hearing the Commission proposes to reintroduce the evidence obtained by it in the so-called public investigation which it has already held to constitute *prima facie* proof that the Masterson suit was inspired by plaintiff through said Eaton, and again to pass upon that evidence. The Comission proposes to do this despite the fact that this Court, through Judge Morris, has determined that such evidence does not constitute even a *prima facie* showing thereof. On information and belief, plaintiff alleges that the Comission does not have and cannot produce any evidence in addition to that in the record of its so-called public investigation which has heretofore been passed upon by this Court. (The Commission's order of August
9 11, 1948, contains allegations not considered in the S. E. C. action; as to those matters no relief is here sought if properly severed for hearing.)

28. The Comission is disqualified to pass upon this issue in the proceedings ordered by its order and notice of August 11, 1948, because it has already made a determination which it has submitted to this Court and upon which this Court has rendered final judgment.

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29. The Commission lacks jurisdiction over the subject matter in the hearing ordered by the Commission's notice and order dated August 11, 1948, and now set for November 15, 1948. The Commission has no jurisdiction under its statutes to invoke any sanctions or penalties with respect to the termination of the underwriting agreement or the alleged instigation of the Masterson suit.

30. The Commission issued its order and notice of August 11, 1948, prior to the decision by Judge Morris of the Securities and Exchange action, despite the fact that it had theretofore represented to Judge Morris that the very purpose of the Securities and Exchange Commission action was to obtain evidence which would enable the Commission to determine whether or not the institution of such a proceeding would be warranted.

31. The Commission has inspired a maximum of publicity adverse to plaintiff, in an endeavor to convince the public that plaintiff was guilty of wrongdoing. Such publicity has done great injury to plaintiff in the conduct of its business as an investment banker. The purpose and effect of the Commission in ordering that the hearing on this issue continue, despite the judgment of the Court above referred to, are to further maintain the false and damaging impressions heretofore created by it concerning the plaintiff, to republish the false and malicious statements made concerning the plaintiff in the so-called public investigation, and to reaffirm publicly the Commission's predetermination to interfere with plaintiff's business as an investment banker.

32. Unless restrained and enjoined by this Court, the Commission will cause great and irreparable damage to plaintiff not only in the enormous expense of defending the proceeding, but also in the damage to its reputation and credit and interference with its business operations, for which plaintiff has no adequate remedy at law.

WHEREFORE, plaintiff prays that unless and until Judge Morris' decision that the record of the Commission's public

investigation does not make a prima facie showing of fraud, be set aside or reversed:

1. A temporary restraining order, preliminary injunction and permanent injunction be issued to restrain and enjoin the Commission and the individual Commissioners from proceeding pursuant to the Commission's orders of August 11, 1948, and October 28, 1948, insofar as those orders relate to or involve the termination of the underwriting agreement between plaintiff and Kaiser-Frazer Corporation, or the alleged instigation of a stockholder's derivative suit for the alleged purpose of avoiding plaintiff's obligations under said underwriting contract.

2. A temporary restraining order, preliminary injunction and permanent injunction be issued by this Court restraining the Commission and the individual Commissioners from taking any evidence, compelling attendance at hearings or taking any action whatsoever, with respect to the above matters.

3. That the Court declare that the judgment of this
11 Court of October 28 ,1948, is binding as *res judicata* on the defendant Commission and that it is without power to conduct the proposed inquiry into the alleged institgation of the Masterson suit.

4. Plaintiff be granted such other further and different relief as may be appropriate.

ARNOLD, FORTAS & PORTER,
1200 Eighteenth Street, N. W.
Washington, D. C.
By ABE FORTAS.

JOSEPH L. WEINER,
52 Wall Street,
New York, N. Y.
Attorneys for Plaintiff.

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12 Filed Nov 10 1948

Exhibit A

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission, held at its office in the city of Washington, D. C., on the 18th day of February, A. D. 1948.

4613-'48

In the Matter of Activities of

OTIS & COMPANY, FIRST CALIFORNIA COMPANY and ALLEN & COMPANY

in the Comon Stock of Kaiser-Frazer Corporation

Order Directing Investigation and Designating Officers to Take Testimony

I

The Commission's public official files disclose that:

A. Since approximately June 13, 1946, the common stock of Kaiser-Frazer Corporation (Kaiser-Frazer) has been registered on the New York Curb Exchange, a national securities exchange, pursuant to Section 12(b) of the Securities Exchange Act of 1934; and

B. Otis & Company, First California Company, and Allen & Company acted as underwriters in three offerings of Kaiser-Frazer common stock pursuant to registration statements under the Securities Act of 1933 effective September 26, 1945, January 23, 1946, and February 3, 1948, respectively. At all times mentioned herein, each of the said underwriters was registered with the Commission as a broker and dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934 and was a member of the National Association of Securities Dealers, Inc., a national securities association registered wit hthe Commission pur-

suant to Section 15A of the Securities Exchange Act of 1934.

II.

Members of the Commission's staff have reported information to the Commission which tends to show the following:

A. Prior to the time the third registration statement of Kaiser-Frazer became effective under the Securities Act of 1933 at or about 5:30 P. M. Tuesday, February 3, 1948, some of the underwriters and other participants in the distribution attempted to dispose of or solicited offers to buy the securities covered by the registration statement.

B. On February 3, 1948, for the purpose of facilitating the distribution, Kaiser-Frazer undertook to stabilize the market for its common stock already outstanding on the New York Curb Exchange. Certain of the underwriters and other participants in the distribution, knowing of the existence of the stabilizing bid entered by Kaiser-
13 Frazer, urged their customers and others to sell to Kaiser-Frazer on the New York Curb Exchange shares of the common stock of Kaiser-Frazer which they already owned.

C. On February 3, 1948, certain participants in the distribution proposed to be made on the following day effected short sales of shares of the common stock of Kaiser-Frazer on the New York Curb Exchange at a price which was below the next preceding different price of those shares on that exchange.

D. On February 3, 1948, the underwriters entered into a contract to purchase from Kaiser-Frazer 900,000 shares of its common stock at $11.50 per share. Thereafter, when the underwriters encountered difficulty in selling those shares to the public at the public offering price specified in the prospectus, one or more of the underwriters conspired to cause the institgation of a lawsuit against Kaiser-Frazer, which lawsuit was not brought in good faith but was brought solely for the purpose of enabling the under-

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writers to evade the commitment which they had made to Kaiser-Frazer.

E. On February 4, 1948, the underwriters of the proposed distribution of 900,000 shares of the common stock of Kaiser-Frazer announced that the stock was being offered publicly and shortly thereafter announced that subscription books on their offering of Kaiser-Frazer common stock had been closed and the selling group terminated, thus implying that the entire offering had been sold to the public pursuant to the terms of the public offering, when in fact most of the shares so offered had not been sold and the underwriters knew that the offering was unsuccessful and that most of the shares could not be sold to the public pursuant to the terms specified in the registration statement.

F. Otis & Company, First California Company, and Allen & Company made use of the mails and means and instrumentalities of interstate commerce and the facilities of the New York Curb Exchange in connection with the transactions and activities described above.

III.

The information reported to the Commission by members of its staff as set forth in Paragraph II hereof, if true, tends to show that Otis & Company, First California Company, and Allen and Company and other persons at present unknown to the Commission violated Section 5 (a) of the Securities Act of 1933 and Sections 9 (a)(4), 10(a) and 10(b) of the Securities Exchange Act of 1934 and Rules X-10A-1 and X-10B-5 under the latter statute.

IV.

The Commission, having considered the aforesaid report by members of its staff, deems it necessary and appropriate that an investigation be made to determine whether Otis & Company, First California Company, and Allen & Company and other persons at present unknown to the Commission have engaged in the acts and practices set forth in paragraph II hereof or in any other acts or practices of

similar purport or object, for the purpose of (1) determining whether the said persons have violated or are about to violate the provisions of Section 5 (a) of the Securities Act of 1933 and Sections 9 (a) (4), 10 (a) and 10 (b) of the Securities Exchange Act of 1934 and Rules X-10A-1 and X-10B-5 under the latter statute, (2) aiding in the enforcement of the said Acts, and (3) aiding in prescribing rules and regulations under the Securities Exchange Act of 1934, and in securing information to serve as a basis for recommending further legislation concerning these matters.

14 V.

IT IS ORDERED, pursuant to the provisions of Section 20 (a) of the Securities Act of 1933 and Section 21 (a) of the Securities Exchange Act of 1934, that an investigation be made to determine the matters set forth in paragraph IV hereof;

IT IS FURTHER ORDERED, purusant to the provisions of Section 19 (b) of the Securities Act of 1933 and Section 21 (b) of the Securities Exchange Act of 1934, that for the purpose of such investigation Anthon H. Lund, Howard A. Judy, Charles J. Odenweller, Jr., William D. Moran, Ashbrook P. Bryant, Walter G. Holden and Charles E. Shreve, and each of them, is hereby designated an officer of the Commission empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence memoranda or other records deemed relevant or material to the inquiry, and to perform all other duties in connection therewith as authorized by law.

By the Commission.

For ORVAL L. DUBOIS,
Secretary.

By NELLYE A. THORSEN,
Assistant to the Secretary.

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15 Filed Nov 10 1948

Exhibit B

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 23rd day of March, A. D., 1948.

4613-'48

Order for Public Investigation and Designating Officers to Take Testimony

In the Matter of

Offiering of Common Stock of Kaiser-Frazer Corporation
File No. GC-53

I.

The Commission's public official files disclose that:

A. Kaiser-Frazer Corporation on January 6, 1948, filed a registration statement under the Securities Act of 1933 with respect to 1,500,000 shares of its common stock which became effective at or about 5:30 P. M. on Tuesday, February 3, 1948.

B. The common stock of Kaiser-Frazer Corporation has been registered on the New York Curb Exchange, a national securities exchange, pursuant to Section 12 (b) of the Securities Exchange Act of 1934, since approximately June 13, 1946.

C. Otis & Company, First California Company and Allen & Company, which were designated in said registration statement as underwriters of the proposed offering of securities therein contemplated, at all times mentioned herein were registered with the Commission as brokers and dealers pursuant to Section 15 (b) of the Securities Exchange Act of 1934 and were members of the National Association of Securities Dealers, Inc., a national securities association

registered with the Commission pursuant to Section 15A of the Securities Exchange Act of 1934.

II.

Members of the Commission's staff have reported information to the Commission which tends to show the following:

A. Upon the effectiveness of the said registration statement the public offering of the common stock of Kaiser-Frazer contemplated thereby was made, but thereafter one or more of the underwriters refused to proceed with the offering.

B. Certain persons sold shares of the common stock covered by the registration statement prior to its effectiveness.

C. In connection with the transactions described in paragraphs A and B hereof, various persons made use of means and instrumentalities of interstate commerce and of the mails.

III.

The Commission, having considered the aforesaid report, deems it necessary and appropriate that an investigation be made for the purpose of (1) determining whether any person, in connection with the matters set forth in paragraph II, has violated or is about to violate Sections 9(a)(4), 10(a), 10(b) and 15(c)(1) of the Securities Exchange of the Securities Exchange Act of 1934, Rules X-10A-1, X-10B-5 and X-15C12 thereunder and Section 5(a) of the Securities Act of 1933, and (2) aiding in (a) the enforcement of the Securities Exchange Act of 1934, (b) the prescribing of rules and regulations thereunder, and (c) securing information to serve as a basis for recommending further legislation concerning the matters to which that Act relates.

IV.

It is ordered, pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Section 20(a) of the Securities Act of 1933, that a public investigation be held to determine the matters set forth in paragraph III hereof;

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IT IS FURTHER ORDERED pursuant to the provisions of Section 21(b) of the Securities Exchange Act of 1934 and Section 19(b) of the Securities Act of 1933, that for the purpose of such public investigation Milton P. Kroll is hereby designated an officer of the Commission to preside at such investigation and Edward H. Cashion, E. Russell Kelly, Milton P. Kroll, Louis Loss, Anton H. Lund and C. J. Odenweller, Jr., and each of them, is hereby empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda or other records deemed relevant or material to the inquiry, and to perform all other duties in connection therewith as authorized by law; and

IT IS FURTHER ORDERED that a public hearing for the taking of testimony begin on the 12th day of April, 1948, at 10:00 A. M., at the office of the Securities and Exchange Commission, 425 Second Street, N. W., Washington, D. C., and continue thereafter at such times and places as may be determined.

By the Commission.

ORVAL L. DUBOIS,
Secretary.

(SEAL)

16 Filed Nov 10 1948

Exhibit C

IN THE

DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF COLUMBIA

No. 2617-48

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff*,

v.

MARVIN C. HARRISON and ALLAN HULL, *Defendants*.

Complaint

The Securities and Exchange Commission (hereinafter referred to as "the Commission") applies to this Honorable Court, pursuant to Section 21(c) of the Securities Exchange Act of 1934 (15 U. S. C. § 78u(c), for an order requiring the defendants to appear before a duly designated officer of the Commission and give testimony concerning the matters referred to in subpoenas *duces tecum* and *ad testificandum* issued by such an officer, and respectfully represents as follows:

1. Jurisdiction is conferred upon this court by Section 21(c) of the Securities Exchange Act of 1934 (15 U. S. C. § 78u(c)).

2. Both defendants are attorneys-at-law practicing in Cleveland, Ohio.

3. On March 23, 1948, the Commission, pursuant to Section 21(a) of the Securities Exchange Act of 1934 (15 U. E. S. § 78u(a)) and Section 20(a) of the Securities Act of 1933 (15 U. S. C. § 78t(a)), orde ed that a public investigation be made in connection with an offering of the common stock of Kaiser-Frazer Corporation. (A copy of the said order is attached as Appendix 1 to the Affidavit of Anthon H. Lund which is filed herewith.) The order, after reciting in paragraph II thereof that members of the Com-

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mission's staff have reported certain information to the Commission, specifies in paragraph III as follows:

> "The Comission, having considered the aforesaid report, deems it necessary and appropriate that an investigation be made for the purpose of (1) determining whether any person in connection with the matters set forth in paragraph II, has violated or is about to violate Section 9(a)(4), 10(a), 10(b) and 15(c)(1) of the Securities Exchange Act of 1934, Rules X-10A-1, X-10B-5 and X-15C-2 thereunder and Section 5(a) of the Securities Act of 1933, and (2) aiding in (a) the enforcement of the Securities Exchange Act of 1934, (b) the prescribing of rules and regulations thereunder, and (c) securing information to serve as a basis for recommending further legislation concerning the matters to which that Act relates."

In paragraph IV of the order, the Commission, pursuant to Section 21(b) of the Securities Exchange Act of 1934 (15 U. S. C. § 78u(b)) and Section 19(b) of the Securities Act of 1933 (15 U. S. C. § 77s(b)), appointed certain officers, including Milton P. Kroll, for the purpose of conducting the investigation and designated the said Milton P. Kroll as the officer to preside at the investigation.

4. Acting pursuant to the authority contained in the said order of March 23, 1948, the presiding officer, on April 28, 1948, issued subpoenas *duces tecum* and *ad testificandum* to the defendants requiring them to appear before him at 10:00 o'clock A. M. on May 5, 1948, at Room 861, Federal Building, Detroit, Michigan, and at that time and
17 place to testify in the matter of the above-mentioned investigation. Service of the said subpoenas was made on the defendants by registered mail and they appeared pursuant thereto. (Copies of the said subpoenas are attached as Appendixes 8 and 9 to the Lund affidavit.)

5. The defendants appeared at the time and place designated in the said subpoenas and gave certain testimony under oath, but declined to answer certain questions on the

claim of attorney-client privilege. When asked to name the client or clients on behalf of whom the privilege was claimed, both defendants declined to answer. When directed to answer by the presiding officer on the ground that disclosure of the name of an alleged client without more is not a privileged communication between attorney and client, both defendants again declined to answer unless required to do so by court order. Accordingly, the defendants were summoned into the United States District Court for the Eastern District of Michigan, Southern Division and under court compulsion appeared again before officers of the Commission and identified their client as Cyrus S. Eaton, who with his family is the majority stockholder of Otis & Company, which was one of the underwriters of the Kaiser-Frazer Corporation stock offiering being investigated.

6. The defendants, having been excused by the presiding officer subject to recall, were subsequently subpoenaed to appear again before him in the Washington offices of the Commission, Room 102, at 10:00 o'clock A. M., June 3, 1948. (Copies of these subpoenas are attached as Appendixes 10 and 11 to the Lund affidavit.)

7. The defendants appeared at the time and place designated and gave certain additional testimony under oath, but again declined to answer certain questions on the claim of attorney-client privilege. One of the issues which has been raised in the pending investigation by the Commission is whether the defendants' client, Cyrus S. Eaton, inspired the filing of a collusive lawsuit by one James F. Masterson on February 9, 1948, in the Circuit Court of Wayne County, Michigan against Kaiser-Frazer Corporation, its officers and directors, Graham-Paige Motor Company (a large stockholder of Kaiser-Frazer), and the underwriting firms of Otis & Company, First California Corporation and Allen & Company. This lawsuit sought an accounting and a permanent injunction against the pending distribution of Kaiser-Frazer Corporation's common stock which is the

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subject of the Commission's investigation. It was a condition precedent of an underwriting contract entered into between Kaiser-Frazer Corporation and the three underwriters on February 3, 1948, that no material legal proceedings be pending against Kaiser-Frazer Corporation as of February 9, 1948, the settlement date. Pursuant to this provision af the contract Otis & Company refused to perform, allegedly because of the filing of the Masterson suit. The questions which the defendants declined to answer related, among other things, to communications between Eaton and the defendants and work performed by them on his behalf in connection with the said Masterson suit. The Commission had considered the nature of the questions being asked, and had instructed the presiding officer to direct the defendants to answer on the ground that there is no privilege where there is a *prima facie* showing that the communications were made in connection with the perpetration of a fraud or other illegal act, and that the evidence in the record established a *prima facie* showing that the defendants' client had consulted them in connection with the perpetration of a fraud involving the filing of a collusive lawsuit. The presiding officer so stated in ruling on the claim of privilege. Both defendants again declined to answer unless required to do so by court order. (The evidence in the record which establishes the *prima facie* showing of fraud is set forth in the Lund affidavit.)

8. The answers to the said questions are deemed to be material to the Commission's investigation.

18 9. The failure of the defendants to answer the said questions has impeded and continues to impede the progress of the investigation. The subject matter of the investigation is such that the Commission deems it necessary in the public interest that the investigation proceed with the greatest possible dispatch.

WHEREFORE, the Commission prays:

A. That an order to show cause pursuant to Rule 81(a)(3) of the Federal Rules of Civil Procedure directing the de-

fendants to appear before this court upon a day certain to be fixed in the order and show cause, if any there be, why an order should not issue herein requiring the defendants to appear before the Commission or an officer duly designated by the Commission, at such time and place as such duly designated officer may order, then and there to answer the said questions concerning the conversations between the defendants and their client, Cyrus S. Eaton, and their activities in his behalf relating to the subject matter of this investigation, and any other questions material to the investigation which are not the subject of the constitutional privilege against self-incrimination.

B. That upon return of the order to show cause, an order be entered herein requiring the defendants so to appear and testify.

C. That the plaintiff have such other and further relief as this court may deem necessary and appropriate.

D. That the court specially appoint Frank D. Emerson and Warren E. Blair, Attorneys, Securities and Exchange Commission, Cleveland Regional Office, for the purpose of serving upon each of the defendants a copy of the order to show cause and a copy of the complaint filed in this case.

LOUIS LOSS, *Chief Counsel,*
Division of Trading and Exchanges.

EDWARD H. CASHION, *Chief Counsel,*
Division of Corporation Finance.

E. RUSSELL KELLY,
CHARLES J. ODENWELLER, JR.,
Attorneys for
Securities and Exchange Commission,
425 Second Street, N. W.
Washington 25, D. C.

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Exhibit D

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission held at its office in the City of Washington, D. C. on the 11th day of August, A. D., 1948

No. 4613-48

In the matter of OTIS & COMPANY
2000 Terminal Tower Building, Cleveland, Ohio

Order for Proceedings and Notice of Hearing On Questions of Revocation and Suspension of Registration As Broker-Dealer Pursuant to Section 15(b) of Securities Exchange Act of 1934 and Suspension or Expulsion From a Registered Securities Association Pursuant to Section 15A(1)(2) of Said Act.

I

The Commission's public official files disclose that:

A. Otis & Company, a Delaware corporation (herein called the registrant), is registered as a broker and dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934, and is a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15A of the said Act.

B. Cyrus S. Eaton controls the registrant and William R. Daley is president thereof.

C. The common stock of Kaiser-Frazer Corporation, a Nevada corporation (herein called K-F), has been registered on the New York Curb Exchange, a national securities exchange, pursuant to Section 12(b) of the Securities Exchange Act of 1934, since approximately June 13, 1946.

D. K-F on January 6, 1948, filed a registration statement under the Securities Act of 1933 with respect to 1,500,000 shares of its common stock, which became effective as of 5:30 P. M. on February 3, 1948.

E. An underwriting agreement was entered into on February 3, 1948, in which the registrant, First California Company and Allen & Company were designated as underwriters of the proposed offering of securities.

II

The Commission, as the result of a public investigation, has obtained information which tends, if true, to show that:

A. The registrant, prior to the effectiveness of the registration statement referred to in paragraph D of Section I hereof, sold, offered for sale and attempted to dispose of certain of the securities covered by the said registration statement.

B. On February 2, 1948, K-F and the underwriters orally agreed that, if K-F would stabilize the market until the close of the New York Curb Exchange on February 3, 1948, the underwriters would purchase the 1,500,000 shares covered by the said registration statement. On February 3, 1948, pursuant to the said oral agreement, K-F stabilized the market for its common stock at $13.50 per share. By the close of the New York Curb Exchange on that day K-F had purchased 186,200 shares on the various exchanges on which the security is traded. The stabilizing operation was directed and managed and the purchase orders were placed by Eaton for K-F's account.

C. Beginning early on the morning of February 3, 1948, and continuing throughout that day, the registrant advised various securities dealers in the proposed selling group and prospective customers (1) that the market was being stabilized that day at $13.50 per share and (2) either that the offering would be made after the close of the market that day at $13.00 per share or that it would be made at that time at one-half dollar below K-F's stabilizing bid. As a result of this advice, and as the registrant intended, securities dealers and customers on February 3, 1948, sold K-F stock at $13.50 per share against K-F's stabilizing bid with a view to repurchasing the securities from the

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underwriters at a price of $12.00 per share to the selling group dealers and $13.00 per share to the public.

D. After the close of the market on the New York Curb Exchange on February 3, 1948, the underwriters upon Daley's insistence refused to enter into an underwriting agreement to purchase the 1,500,000 shares. Thereafter a compromise was effected by which the underwriters agreed to purchase 900,000 shares and to use their best efforts to sell the balance of 600,000 shares. An underwriting agreement incorporating this compromise was executed shortly before 5:30 P. M. on that day. Under this agreement the purchase price to the underwriters was $11.50 per share for the 900,000 shares and $11.60 per share for the 600,000 shares; the offering price to the public was $13.00 per share; the registrant's individual commitment was 337,500 shares; and February 9, 1948, at 10:00 A. M., in Cleveland, Ohio, was designated as the time and place for settlement.

E. The registrant executed the underwriting agreement with the intention to fulfill its obligations thereunder only if the offering could be distributed profitably to the public, and in confirmations to various persons represented that it had sold certain of the securities to them. This intention was not disclosed to K-F, to the members of the selling group or to the various purchasers of the securities.

F. The underwriters were unable to sell the entire issue to the public at the offering price. Shortly after noon on February 4, 1948, they announced that the offering had been terminated and the syndicate books closed, and that the issue had all been sold to the public. By that time the underwriters had sold to the public a total of approximately 320,000 shares of the 1,500,000 shares offered, and had purchased approximately 47,000 shares for their own account in stabilization.

G. On February 4, 1948, Eaton advised K-F that the registrant would not perform its obligations under the underwriting agreement and demanded that the registrant be released. K-F refused and insisted that the registrant purchase and pay for its share of the firm commitment in accordance with the terms of the underwriting agreement.

H. The underwriting agreement provided that it could be terminated by the underwriters if at the time for settlement any material litigation were pending or threatened against K-F, except as disclosed by the registration statement. For the purpose of evading its obligations under the underwriting agreement through this provision, the registrant through Eaton caused a lawsuit against K-F to be filed on February 9, 1948, before 10:00 A. M. in the Circuit Court for the County of Wayne, Michigan. At the time and place for settlement the registrant refused to consumate the underwriting agreement and asserted that it was released from its obligations thereunder because of the lawsuit. The registrant omitted to state to K-F, the co-underwriters, and purchasers that it had caused the said lawsuit to be filed.

I. The registrant effected certain of the transactions in Section II hereof otherwise than on a national securities exchange.

21 J. The registrant used the mails, means and instrumentalities of interstate commerce, and means and instruments of transportation and communication in interstate commerce in effecting certain of the transactions in, and inducing the purchase and sale of, the securities in the transactions mentioned in Section II hereof.

III

The information set forth in Section II above tends, if true, to show that:

A. The registrant violated Section 5(a)(1) of the Securities Act of 1933 in that it used and caused to be used means and instruments of transportation and communication in interstate commerce and the mails to sell the securities mentioned in paragraph A of Section II above, through the use and medium of prospectuses and otherwise, when no registration statement was in effect as to such securities.

B. The registrant violated Section 17(a) of the Securities Act of 1933 in that, in the sale of securities by the use

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of means and instruments of transportation and communication in interstate commerce and by the use of the mails, the registrant directly and indirectly employed devices, schemes and artifices to defraud, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in transactions, practices and a course of business which would and did operate as a fraud and deceit upon the purchasers.

C. The registrant violated Section 10(b) of the Securities Exchange Act of 1934 in that, by use of means and instrumentalities of interstate commerce and of the mails, and of facilities of national securities exchanges, the registrant, in connection with the purchase and sale of securities, directly and indirectly, employed devices, schemes, and artifices to defraud, made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in acts, practices, and a course of business which would and did operate as a fraud and deceit upon certain persons, in contravention of Rule X-10B-5, prescribed by the Commission under the said section.

D. The registrant violated Section 15(c)(1) of the Securities Exchange Act of 1934 in that it made use of the mails and of means and instrumentalities of interstate commerce to effect transactions in and to induce the purchase and sale of securities, otherwise than on a national securities exchange, by means of manipulative, deceptive and other fraudulent devices and contrivances as defined by Rules X-15C1-2(a) and (b), prescribed by the Commission under the said section.

E. The registrant violated Section 9(a)(4) of the Securities Exchange Act of 1934 in that, for the purpose of inducing others to purchase and sell a security registered on national securities exchanges, the registrant made state-

ments which, at the time and in the light of the circumstances under which they were made, were false and misleading with respect to material facts and which the registrans knew or had reasonable grounds to believe were false and misleading.

IV

The Commission, having considered the aforesaid information, deems it necessary and appropriate in the public interest and for the protection of investors that proceedings be instituted to determine:

22 (a) Whether the statements set forth in Section II hereof are true;

(b) Whether the registrant has willfully violated Section 5(a)(1) of the Securities Act of 1933;

(c) Whether the registrant has willfully violated Section 17(a) of the Securities Act of 1933;

(d) Whether the registrant has willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Rule X-10B-5, prescribed by the Commission under the said section;

(e) Whether the registrant has willfully violated Section 15(c)(1) of the Securities Exchange Act of 1934 and Rules X-15C1-2(a) and (b), prescribed by the Commission under the said section;

(f) Whether the registrant has willfully violated Section 9(a)(4) of the Securities Exchange Act of 1934;

(g) Whether, pursuant to Section 15(b) of the Securities Exchange Act of 1934, it is in the public interest to revoke the registration of the registrant;

(h) Whether, pursuant to Section 15(b) of the Securities Exchange Act of 1934, it is necessary or appropriate in the public interest or for the protection of investors to suspend the registration of the registrant pending final determination; and

(i) Whether, pursuant to Section 15A(1)(2) of the Securities Exchange Act of 1934, it is necessary or appropriate in the public interest or for the protection of in-

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vestors or to carry out the purpose of the said section to suspend the registrant for a period not exceeding twelve (12) months or to expel the registrant from membership in the National Association of Securities Dealers, Inc.

V

IT IS HEREBY ORDERED that a hearing for the purpose of taking evidence on the questions set forth in Paragraph IV hereof be held at 10:00 A. M. on September 20, 1948, at the Cleveland Regional Office of the Securities and Exchange Commission located at 1370 Ontario Street, Cleveland, Ohio, before Edward C. Johnson, Hearing Examiner. Upon the completion of the taking of evidence in this matter, the hearing officer shall prepare a recommended decision pursuant to Rule IX(b) of the Rules of Practice, unless such decision is waived.

This order and notice shall be served on the registrant personally or by registered mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding shall be permitted to participate or advise in the decision upon this matter except as a witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed to be subject to the provisions of that section delaying the effective date of any final Commission action.

By the Commission.

ORVAL L. DUBOIS,
Secretary.

23 Filed Nov 10 1948

Exhibit E

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

No. 2617-48

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff*,

v.

MARVIN C. HARRISON & ALLEN HULL

Informal Memorandum

It seems certain that the matters and issues now under consideration by Judge Morris in Securities and Exchange Commission v. Harrison, et al., No. 2617-48, will arise in the proceedings ordered by SEC in its order of August 11, 1948. It follows that the motion of the defendants and intervenors should be sustained, and the Commission enjoined as prayed.

Whereas proceedings for the revocation and suspension of the registration of Otis & Company have been ordered by the SEC and since SEC will have statutory duty and authority to review the action taken by NASD, it is deemed appropriate that NASD be joined in case No. 2617-48 now before Judge Morris, in order that complete relief may be accorded between the parties to that suit within the meaning of Rule 19(b).

NASD urges that defendants and intervenors may not proceed against it, since they have not exhausted their administrative remedies. The point is not well taken. It will be impossible for defendants and intervenors to exhaust their administrative remedies so long as the SEC is enjoined. An essential step in the administrative remedies is a review by SEC when NASD has acted. Administrative remedies are not available in view of the injunction against SEC. The motion of defendants and intervenors

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to make NASD a party is sustained and the injunction asked against it will be granted.

24 Counsel for defendants and intervenors will present for settlement, Findings of Fact, Conclusions of Law and an appropriate order consistent herewith.

F. DICKINSON LETTS,
Judge.

25 Filed Nov 10 1948

Exhibit F

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

No. 2617-48

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff*,

v.

MARVIN C. HARRISON AND ALLAN HULL, *Defendants*

Order for Injunction Pendente Lite Against Securities and Exchange Commission

On motion of counsel for intervenors Cyrus S. Eaton and Otis & Co., counsel for moving parties and for the Securities and Exchange Commission having been heard and it appearing that the Securities and Exchange Commission has issued a Notice and Order for Hearing against said intervenors and that unless restrained, a hearing will be held injurious to intervenors, and it appearing that the holding of such a hearing may involve interference with the jurisdiction of this Court in the above entitled matter, and it further appearing that it is necessary to protect the jurisdiction of this Court,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED:

That plaintiff Securities and Exchange Commission is hereby restrained and enjoined, pending the decision of Judge Morris in this cause, namely Securities and Exchange Commission, plaintiff, v. Marvin C. Harrison and Allan Hull, defendants, No. 2617-48,

26 (1) from taking any action whatsoever in pursuance of its Order dated August 11, 1948, and entitled In the Matter of Otis & Co., with respect to any matter which is pending relating to the termination of the contract between Otis & Co. and Kaiser-Frazer Corporation or into the alleged inspiration of the said derivative stockholders' suit; and

(2) that in connection therewith that the Commission be restrained and enjoined from presenting any evidence, compelling attendance at hearings or taking any action whatsoever with respect to the specified matters.

Bond is waived by the parties.

F. Dickinson Letts,
Judge.

September 21, 1948
Approved as to form and waiver of bond:
(9/20) Louis Loss
(9/20) Thurman Arnold
Counsel for moving parties.

27 Filed Nov 10 1948

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

No. 2617-48

Securities and Exchange Commission, *Plaintiff,*

v.

Marvin C. Harrison and Allan Hull, *Defendants.*

Findings of Fact and Conclusions of Law in Support of Injunction Pendente Lite Against Securities and Exchange Commission.

I. Findings of Fact.

1. The within action was commenced by plaintiff, Securities and Exchange Commission, on June 25, 1948. De-

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fendants and intervenors answered and counterclaimed on July 9, 1948. The matter is now awaiting decision.

2. On August 11, 1948, plaintiff commenced a proceeding before it against Otis & Co., one of the intervenors, the nature of which is shown by its order, and directed that hearings commence on September 20, 1948.

3. The matters and issues now under consideration by Judge Morris herein will arise in the proceeding ordered by the plaintiff before it.

4. If the said hearings are held Otis & Co. will suffer injury by publicity adverse to its good will and business and will incur substantial expense in preparation for and in the conduct of the hearing which would involve unnecessary waste of funds not recoverable from the SEC.

28 II. Conclusions of Law.

1. The matters and issues now under consideration by Judge Morris in the above-entitled matter will arise in the proceedings ordered by the SEC in its order of August 11, 1948.

2. The holding of such a hearing may involve irreparable injury to the intervenors.

3. The holding of such a hearing will involve interference with the jurisdiction of this Court.

4. An injunction against further proceedings by the SEC in the matters as to which its jurisdiction is contested is necessary to protect the jurisdiction of this Court and to permit appropriate consideration of pending matters in this Court.

5. No public or private interest will be injured by the granting of this injunction.

6. This Court has jurisdiction to enter an injunction against proceedings by the SEC in the manner prayed for.

F. Dickinson Letts,
Judge.

September 21, 1948

29 Filed Nov 10 1948

Exhibit G

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 2617-48

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff*,

v.

MARVIN C. HARRISON AND ALLAN HULL, *Defendants*,
CYRUS S. EATON AND OTIS & COMPANY, *Intervenors*.

Memorandum

MORRIS, J. This is a proceeding in which the Securities and Exchange Commission has applied to this Court, pursuant to Section 21(c) of the Securities Exchange Act of 1934, 15 U. S. C., Section 78u(c), for an order requiring the defendants to appear before a duly designated officer of the Commission and give testimony concerning the matters referred to in subpoenas *duces tecum* and *ad testificandum* issued by such an officer. It is alleged that the subpoenas were issued in a proceeding conducted by the Commission to investigate certain matters relating to an offering of the common stock of the Kaiser-Frazer Corporation. The defendants refused to give certain testimony upon the ground that the same was within the attorney-client privilege, and even failed to disclose the name of the client on whose behalf they claimed such privilege. Proceedings were then had in the United States District Court for the Eastern District of Michigan, Southern Division, to require the disclosure of the name of the client, or clients, for whom they were acting. This they were required to do, disclosing the name of their client as Cyrus S. Eaton, who, with his family, is the majority stockholder of Otis & Company, which was one of three underwriters of the Kaiser-Frazer Corporation's stock offering being investigated. Pursuant to an adjournment, the defendants appeared at a subse-

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quent time and place designated and gave certain additional testimony under oath, but again declined to answer certain questions on the claim of attorney-client privilege. One of the issues which has been raised in the pending investigation by the Commission is whether the defendants' client, Cyrus S. Eaton, caused the filing of an alleged collusive lawsuit by one James F. Masterson on February 9, 1948, in the Circuit Court of Wayne County, Michigan, against Kaiser-Frazer Corporation, its officers and directors, Graham-Paige Motor Company, a large stockholder of Kaiser-Frazer Corporation, and the underwriting firms of Otis & Company, First California Corporation, and Allen & Company. This lawsuit sought an accounting and a permanent injunction against the pending distribution of Kaiser-Frazer Corporation's common stock, which is the subject of the Commission's investigation. It was a condition precedent of an underwriting contract, entered into between Kaiser-Frazer Corporation and the three underwriters on February 3, 1948, that no material legal proceedings be pending against Kaiser-Frazer Corporation as of February 9, 1948, the settlement date. Pursuant to this provision of the contract (and upon other grounds), Otis & Company refused to perform. The questions which the defendants declined to answer related, among other things, to communications between Eaton and the defendants and work performed by them on his behalf in alleged connection with the said Masterson suit. It is the position of the Commission that, if Eaton induced and inspired the filing of the Masterson suit for the purpose of affording a basis upon which Otis & Company could refuse to perform the underwriting contract with Kaiser-Frazer Corporation, such action is fraudulent, and, upon a *prima facie* showing that such fraud had been perpetrated, the defendants could not decline upon the ground of attorney-client privilege to give the testimony sought. The Commission filed an affidavit by one Anthon H. Lund, Assistant Director of the Division of Trading and Exchanges of the Securities and Exchange Commission, which purports to summarize such parts of the

record of the proceedings and evidence had in the investigation proceedings upon which the Commission relies to show that there is evidence, other than the testimony sought from the defendants, sufficient to constitute a prima facie
showing that the alleged fraud had been perpetrated
31 by Eaton, acting through the defendants and others.

Upon motion Cyrus S. Eaton and Otis & Company were permitted to intervene in these proceedings. The defendants and intervenors, in answer to the complaint, deny the jurisdiction of the Commission to conduct the proceedings in which the subpoenas were issued. They assert that the complaint fails to charge any fraud which would, if shown by *prima facie* evidence, destroy the attorney-client privilege, and thereupon ask the dismissal of the complaint. They further deny the acts charged in the complaint, which are asserted by the Commission to be fraudulent. They deny that any evidence in the proceedings constitutes a *prima facie* showing that the alleged fraud was perpetrated. They, therefore, assert that the attorney-client privilege has not been destroyed, and the defendants should not be required to testify concerning privileged communications. The defendants and intervenors insist that the Lund affidavit may not be used in lieu of the record, and, furthermore, that the evidence contained in the record should not be received and relied upon, because of the nature and conduct of the proceedings, and the failure to permit cross-examination of the witnesses. They ask relief in these regards by appropriate motions. By counterclaim the defendants and intervenors complain that the investigation proceedings were not instituted and conducted for the *bona fide* purpose of enforcement of the Securities Exchange Act, as amended, but for the purpose of giving publicity to the charges of the Kaiser-Frazer Corporation against the intervenor Otis & Company, and to procure information helpful to the said Kaiser-Frazer Corporation in a proceeding now pending in the United States District Court for the Southern District of New York, wherein the Kaiser-Frazer Corporation is plaintiff, seeking damages

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against said intervenor and others. Whereupon, by said counterclaim, the defendants and intervenors seek injunctive relief against the Commission to prevent further public investigation of the matters set forth in the complaint, further public statements prejudicial to the reputation of the defendants and intervenors, or any statements purporting to make findings or conclusions on the basis of said
32 investigation, or any further investigation limited to matters in aid of the said Kaiser-Frazer Corporation's suit.

A hearing was had on July 19, 20 and 21, 1948, at which time, following argument, the record, consisting of approximately 6,000 pages, and the exhibits were filed by the Commission, subject to a motion of defendants and intervenors to strike on the grounds heretofore mentioned. Leave was granted to the parties to file briefs and appendices, pursuant to which the Commission filed its supplemental brief on August 3rd, and defendants and intervenors filed supplemental brief on August 31st.

I have no difficulty with the question as to whether or not the Commission has jurisdiction to conduct the investigation in which the subpoenas here sought to be enforced were issued. Underwriting transactions are so intimately related to the sale and purchase of securities, and have such direct effect upon the recognized responsibilities of the Commission, that it cannot be said Congress did not contemplate that the Commission should have power to investigate alleged fraudulent practices relating thereto.

It is a well recognized principle of administrative law that investigations ought to be so conducted that harmful publicity will not be used in lieu of sanctions provided by law, but it must rest in the sound discretion of the agency created by the Congress, and not with the courts, to determine when investigations are to be conducted by open or closed hearings. The limitation placed by the Court, in the case of *Bank of America National Trust and Savings Association* v. *Douglas, et al.*, 70 U. S. App. D. C. 221, 105 F. (2d) 100, was upon the public disclosure of confidential

reports of bank examiners made to the Comptroller of the Currency with reference to the bank there involved. The use "in confidence" of such reports was specifically authorized by Congress, and the only statutory reference to publicity is in the Comptroller's qualified authority to publish the report on any bank which fails to comply with his recommendations. In the instant proceedings there is no comparable situation. If an analogy be sought between the reports involved in the *Bank of America case* and the communications here claimed to be privileged, it is ap-
33 parent that they do not stand on the same footing. The bank reports could be used by the Commission in confidence, but not in public; the communications here involved, if privileged, may not be used, even ascertained, by the Commission either in confidence or publicly. If they be not privileged, there is no limitation on their use or ascertainment.

I cannot agree with the contention of the defendants and intervenors that the complaint failed to charge fraudulent conduct. If the Masterson suit was in fact induced and inspired by the client of the defendants to afford the basis of relieving Otis & Company from the obligations of the underwriting agreement with Kaiser-Frazer Corporation, any communications to further such actions were, in my opinion, beyond the immunity of the attorney-client privilege. That privilege has long been recognized as a very proper and necessary one to insure full and complete revelation by a person to an attorney to the end that the client may be properly advised, represented, and, in appropriate cases, defended by that attorney. To subject such revelations to exposure by the testimonial process would inevitably lead to concealments which would impair proper representation and thus interfere with proper administration of justice. While it relates to the rights of an individual, it is nonetheless recognized, as so many of our fundamental rights are, as essentially in the public interest. This privilege has, however, never been intended to be, and

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should not be, a cloak or shield for the perpetration of a crime or fraudulent wrong doing. One who consults an attorney to secure aid or assistance in the perpetration of a future crime or fraudulent wrong doing is not consulting that attorney for the legitimate purposes which are protected by the privilege. If, therefore, it be shown by evidence other than the disclosure of the communications between client and attorney that aid or assistance is being sought by for the perpetration of crime or fraudulent wrong doing, there is no immunity to the testimonial process respecting such communications. It has long been recognized, in both the English and American courts, that the party attacking the privilege on the ground that communications were to further a fraudulent purpose must produce sufficient evidence to sustain a finding that the communica-
34 tions were for such wrongful purpose before evidence as to the communications will be required.[1] Various expressions of this rule have been cited in brief and argument in these proceedings, but, upon analysis and a full reading of their context they come in effect to this statement of the rule.

The defendants and intervenors insist that there is a further limitation upon the disclosure of communications made by the client to an attorney, even though in furtherance of a crime or fraudulent wrong doing, and that is that only when such fraud is an issue in actual litigation may a disclosure of the communications relating thereto be required. This is grounded upon the decision in *Alexander* v. *U. S.*, 138 U. S. 353. In that case Alexander was convicted of murder. The trial court had admitted evidence by an attorney to the effect that, during the interval between the murder and the finding of the body, Alexander had consulted him, saying that his partner was missing and had taken away some money, and inquiring whether he could hold certain horses of the partnership to secure the money.

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[1] Rule 212 of the American Law Institute's Model Code of Evidence.

The Supreme Court reversed, distinguishing *Regina* v. *Cox*, 14 Q. B. D. 153, saying,

> This case, however, is clearly distinguishable from the one under consideration, in the fact that the solicitor [in the Cox case] was consulted with regard to a scheme to defraud, for which his clients were *subsequently* indicted and tried, and the testimony was offered upon that trial; while in this case the consultation was had *after the crime was committed*, and was offered in evidence as an admission tending to show that defendant was concerned in the crime, or rather as a statement contradictory to one he had made upon the stand. Had he been indicted and tried for a fraudulent disposition of his partner's property, the case of *Reg.* v. *Cox* would have been an authority in favor of admitting this testimony, but we think the rule announced in that case should be limited to cases where the party is tried for the crime in furtherance of which the communication was made. [Italics supplied.]

Considered in the factual situation of the *Alexander case*, it would seem that the distinction made with the *Cox case* was rather as to the time of the communications with reference to the offenses involved than a holding that, with a proper showing being made, disclosure of communications could not be required in an investigatory proceedings, as contended by the defendants and intervenors. While it is true, as defendants and intervenors state, that ordinarily an investigatory body finishes its task when a *prima facie* case of fraud is shown and there is, therefore, no necessity for going further and requiring the disclosure of a communication otherwise privileged in order to establish the fact of fraud I can see no legitimate reason why, if the requisite showing has been made which justifies the piercing of the privilege, evidence in that situation, which is certainly competent, cannot be required and given in an investigatory proceedings, and I do not believe the

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decision in the *Alexander case* was intended to hold otherwise.

The question is, therefore, squarely met as to whether or not there is evidence which takes the communications out of the rule of attorney-client privilege. This evidence consists in part of testimony as to certain statements by the intervenor, Cyrus S. Eaton, and in part of documentary evidence as to numerous telephone conversations during the critical period after the attempted stabilization of the stock on the market, and immediately prior to the settlement date under the terms of the underwriting contract. The statements of Eaton as to which testimony was given are to the effect that he would not go through with the agreement; that he threatened that there would be administrative investigations, the stock would fall to $5, and "hell will be popping" if Kaiser-Frazer insisted on holding Otis & Company to the contract. Testimony was also given that Eaton stated in substance, "I am going through the purchase agreement and the registration statement with a fine tooth comb and try and find something to hang my hat on;" "I will find something that I won't be bound by, because I don't propose to go through with it;" and "I would rather have a lawsuit on my hands than be broke." There is also testimony to the effect that he asked his attorney to find a way out and what the measure of damages would be in the event of a cancellation without cause. The documentary record of long-distance telephone calls show calls between February 5th and February 9th between the intervenor Eaton and certain parties and among such calls
36 are at least two from Robert Bulkley and James Masterson and several calls from M. C. Harrison (one of the defendants) to David Martin, who is the attorney who filed the Masterson suit. There is no evidence as to the telephone conversations themselves which shows that Eaton, or any one acting for him, induced or sought to induce the filing of the Masterson suit. There is testimony that inquiry was made by Harrison of A. L.

Pomerantz in a telephone conversation concerning other matters as to whether or not Pomerantz was interested in the filing of a suit against Kaiser-Frazer. Pomerantz testified that his firm had been looking into Kaiser-Frazer for some time, that they had in fact drafted a complaint, but that he did not know positively whether they had actually served a summons and complaint. Pomerantz stated that he understood the inquiry to be whether or not an action had been filed, or would be filed, and that positively Harrison did not state that he wanted Pomerantz to file such an action. He further testified that he called Harrison back the next day and stated that the action had not been filed. There is also evidence that defendant Harrison sent his younger partner, the defendant Hull, to Detroit from Cleveland to ascertain whether or not a suit against Kaiser-Frazer Corporation was filed on the morning of February 9th, which was the day it was filed, and which was also the closing date of the agreement. There is some testimony as to the choice by Masterson of Martin as the attorney to file his suit, and the Commission insists that the explanation of such choice is not considered credible.

Certain of the circumstantial facts here depended upon testimony, while others rest upon documentary evidence. It is insisted by the defendants and intervenors that, inasmuch as the witnesses were not subject to cross-examination in the investigatory proceedings their testimony should not be considered in determining whether or not a *prima facie* case of fraud has been made. With this I cannot agree, but, in determining whether or not testimony given under such circumstances in itself, or in conjunction with documentary evidence, constitutes a *prima facie* case, unquestionably it must be viewed in the light that the witnesses were not subjected to cross-examination. No one trained and experienced in considering the testimony of wit-
37 nesses and making decisions based thereon can fail to realize that a witness' testimony cannot be considered to have the same reliability when his statements have

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not been subjected to full and fair cross-examination. This, in no sense, is concerned only with the veracity of the witness, but as well with his choice of language, honest recollection and explanation. Of necessity, in investigatory proceedings frequently, and in grand jury proceedings uniformly, the examination of witnesses does not include cross-examination. Such testimony for that reason is not to be disregarded, as defendants and intervenors contend, but it must be subjected to the strictest scrutiny for possible ambiguity and equivocation.

It is insisted that inferences should be drawn from the evidence that Eaton, through the defendants and others, inspired and induced the filing of the Masterson suit. It is urged that, in considering whether or not the evidence is sufficient to pierce the attorney-client privilege, every inference favorable to the contention of the Commission should be made. In considering whether a *prima facie* case has been made, reasonable inferences from circumstances proved should be made to support the ultimate facts constituting the *prima facie* case, but, of course, this does not mean that an inference of guilt or wrong doing can be made where that ultimate fact may not be reasonably drawn from the circumstantial facts established. It is quite apparent that the circumstantial facts proved are reasonably consistent with inquiries as to whether or not a derivative suit had been, or would be, filed, as with actually seeking to induce or cause the filing of a suit. In this situation, I cannot believe that *Curley* v. *United States* 81 U. S. App. D. C. 389, 160 F. (2d) 229 compels the conclusion that a *prima facie* case of guilt or wrong doing has here been established. In any event, I do not consider the circumstances here proved to be such, without more, as to reasonably justify a verdict of wrong doing which could be sustained, and I, therefore, must conclude that the requisite *prima facie* showing of fraud to pierce the attorney-client privilege and relieve the communications here sought to be disclosed from immunity has not been made.

38 The Court, in these proceedings, is not required, nor would it be proper, to make findings as to whether or not the fraud charged was perpetuated, but only to determine whether or not the evidence in the record, without more, constitutes a *prima facie* showing of such fraud. It should also be clearly understood that the Court is not passing on the claim of immunity respecting testimony other than communications between the intervenor and his attorneys. There is a note in the brief of the Commission to the effect that certain acts of the attorneys, about which the defendants were questioned, do not come within this scope, but no argument, oral or written, was made on this point, nor is any action by this Court sought on this ground.

With respect to the counterclaim, I am of the view that such relief as the defendants and intervenors claim therein, and which can be properly granted, will be afforded by the refusal of this Court to enforce obedience to the subpoenas in so far as they seek to require testimony concerning communications falling within the attorney-client privilege. I am of the further view that, in so far as the counterclaim seeks injunctive relief respecting the future conduct of the hearings in the investigatory proceedings, the defendants and intervenors are not entitled to the relief sought, and that this Court does not have the power by injunctive relief to control the conduct of such hearings by the Commission.

Other matters urged by the parties in this case, in addition to those mentioned in this memorandum, have been fully considered but do not, in my opinion, alter the conclusions reached.

In the view stated, the motion to dismiss the complaint and the motion to strike the record filed in lieu of the Lund affidavit will be denied. The order sought by the Commission to enforce the subpoenas directed to the defendants in so far as they call for testimony and evidence relating to communications with their client, Cyrus S. Eaton, or re-

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quire a disclosure of such communications, will be denied. The motion to dismiss the counterclaim and interrogatories with reference thereto will be granted. Counsel will prepare orders to carry this decision into effect.

October 18, 1948. *Judge.*

39 Filed Nov 10 1948

Exhibit H

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 2617-48

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff*,

v.

MARVIN C. HARRISON and ALLAN HULL, *Defendants*,
CYRUS S. EATON and OTIS & Co., *Intervenors*.

Order

This matter having come on to be heard upon the complaint of the Securities and Exchange Commission filed July 25, 1948, and the answer and counterclaim of the defendants and intervenors filed July 9, 1948, and the plaintiff having submitted the record of the proceedings before it entitled "In the Matter of Offering of Common Stock of Kaiser-Frazer Corporation (File No. GC-53)" in support of its said complaint, and plaintiff having closed its case, and counsel having been heard, and the Court having filed its Memorandum dated October 18, 1948, which is designated as the Court's findings of fact and conclusions of law, denying the motions of defendants and intervenors to dismiss the complaint for insufficiency and to strike the said proof in support thereof but finding that the said proof did not warrant the relief asked for in the complaint, and further concluding that the Court lacks the power to grant

the relief sought for in the counterclaim, it is hereby

40 ORDERED, ADJUDGED AND DECREED

1. That the motion to dismiss the complaint be and it is hereby denied.

2. That the motion to strike the record of the investigation before the Securities and Exchange Commission be and it is hereby denied.

3. That the order sought by the plaintiff Securities and Exchange Commission to enforce the subpoenas directed to the defendants in so far as they call for testimony and evidence relating to communications with their client Cyrus S. Eaton or require a disclosure of such communications be and it is hereby denied, without costs.

4. That the counterclaim and the interrogatories with reference thereto be and they are hereby dismissed, without costs.

/s/ JAMES W. MORRIS,
United States District Judge.

October 28, 1948

Approved as to form:

/s/ LOUIS LOSS
Attorney for Plaintiff

/s/ THURMAN ARNOLD
Attorney for Defendants and Intervenors

October 28, 1948

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41 Filed Nov 10 1948

Exhibit I

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission held at its office in the City of Washington, D. C., on the 28th day of October, 1948

In the Matter of

OTIS & COMPANY
2000 Terminal Tower Building
Cleveland, Ohio

Order Setting Date and Place of Hearing

The Commission having by order of August 11, 1948, instituted proceedings pursuant to the provisions of Section 15(b) of the Securities Exchange Act of 1934 to determine whether to revoke or suspend the broker-dealer registration of Otis & Company, and whether to suspend or expel the said company from membership in the National Association of Securities Dealers, Inc., and the commencement of the hearing in said proceedings having been scheduled for September 20, 1948, at the Cleveland Regional Office of the Commission;

The United States District Court for the District of Columbia having entered an order on September 21, 1948, enjoining and restraining the Commission, pending the decision of the said court in the matter of Securities and Exchange Commission v. Harrison and Hull et al., from taking any action whatsoever in pursuance of the Commission's order referred to above with respect to any matter relating to the termination of the underwriting contract entered into between Otis & Company and Kaiser-Frazer Corporation on February 3, 1948, or with respect to the alleged inspiration of the stockholders' suit filed by James F. Masterson on February 9, 1948, against

Kaiser-Frazer Corporation, et al. in the Circuit Court of Wayne County, Michigan;

The United States District Court of the District of Columbia having made its decision and entered an order pursuant thereto on October 28, 1948;

Counsel for respondent having requested that the place of hearing be changed to Washington, D. C., and

The Commission having duly considered the matter and being fully advised in the premises;

IT IS HEREBY ORDERED that the hearing referred to in the first paragraph hereof shall commence at 10:00 A. M. on November 15, 1948, at the office of the Securities and Exchange Commission, 425 Second Street N. W., Washington, D. C., and may be adjourned to such other times and such other places as the hearing examiner shall thereafter designate.

By the Commission.

/s/ ORVAL L. DUBOIS,
Secretary.

(SEAL)

42 Filed Nov 10 1948

Motion for Injunction Pendente Lite

Otis & Co., plaintiff herein, moves this Honorable Court for an injunction *pendente lite* against the Securities and Exchange Commission and the individual defendants herein pending the final disposition of this cause from

(a) proceeding pursuant to the Commission's orders of August 11, 1948, and October 28, 1948, insofar as those orders relate to or involve the termination of the underwriting agreement between plaintiff and Kaiser-Frazer Corporation, or the alleged instigation of a stockholder's derivative suit for the alleged purpose of avoiding plaintiff's obligations under said underwriting contract;

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(b) taking any evidence, compelling attendance at hearings, or taking any action whatsoever, with respect to the above matters.

For reason therefor, plaintiff asserts that the issue which the Securities and Exchange Commission is proposing to hear and determine before itself has already been heard and determined by this Court, which has ren-
43 dered final judgment thereon; that the Commission, while such judgment remains unmodified and unreversed, has no power or authority to hold the projected hearing and to inquire into these matters; and that to hold such a hearing would subject Otis & Co. to the vexation and expense of extensive litigation, and other great and irreparable injury,—all as more fully set out in the complaint and the affidavits filed in support of this motion.

Respectfully submitted,

ARNOLD, FORTAS & PORTER.
/s/ By ABE FORTAS.
THURMAN ARNOLD
ABE FORTAS
MILTON V. FREEMAN,
1200 18th Street, N. W.
Washington, D. C.
JOSEPH L. WEINER
52 Wall Street
New York, New York
Attorney for Plaintiff

58 Filed Nov 10 1948

Affidavit of William R. Daley

STATE OF NEW YORK, *County of New York*, ss:

WILLIAM R. DALEY, being duly sworn, deposes and says that:

He is president of Otis & Co., plaintiff herein. Otis & Co. is a Delaware corporation maintaining its principal offices

at 2000 Terminal Tower, Cleveland, Ohio. Otis & Co. is one of the leading investment banking houses in this country; it was the only investment firm which was willing to finance Kaiser-Frazer Corporation when that corporation was first incorporated in 1945 as a new venture in the automobile field. In January 1946, Kaiser-Frazer Corporation requested Otis & Co. to undertake additional financing for it which was again successfully accomplished, thereby furnishing the company in all some $57,000,000. of public money.

The enterprise ran into difficulties and in January 1947 officials of the company found it necessary to offer personal guarantees for a $12,000,000. loan made by Kaiser-Frazer to raise working capital. A few months later they
59 again approached Otis & Co. for further financing, stating as one of their reasons that they desired to be relieved of their personal obligations. They were advised by Otis & Co. that this motive would hardly appeal to the investment public and that a record of successful operations would have to be shown before further financing could be attempted. In July 1947, Kaiser-Frazer informed Otis & Co. that it was operating successfully and that it would soon be in a position to undertake further public financing and suggested and arranged for the inclusion of First California Corporation and Allen & Co. as participating underwriters.

In December 1947, Kaiser-Frazer Corporation advised Otis & Co. that it was ready to proceed and requested the utmost expedition. Accordingly, the registration statement already prepared by the company was revised and was filed with the Commission on January 6, 1948. It provided for the sale of 1,500,000 shares of common stock but did not specify either the price to the public or the proceeds to the issuer. Kaiser-Frazer was anxious to obtain for its stock an amount of money which would have required that the market be 15 or over and since the market was below that, it seemed that no offer was imminent.

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On February 2, Kaiser-Frazer indicated a willingness to accept a price of $12. a share, provided the market was $14. on the following day. In order to assure a favorable market on the following day, Kaiser-Frazer's officers requested the underwriters to "stabilize" i.e., to purchase in the market a sufficient volume of stock to insure favorable quotations. Otis & Co. and First California Corporation, the managing underwriters, promptly refused to do so, both on the ground that there would be no commitments prior to the signing of a contract and on the further ground that it was not to the interest of the underwriters, but rather against their interests, to have a high price for the stock that was to be offered.

Kaiser-Frazer Corporation then announced that, if it went forward, it would itself "stabilize" and sent one of its attorneys to Washington to consult the staff of the Commission as to how far it could go in such stabilization; more specifically, whether it could make bids to buy on an ascending scale or would be limited to purchase at a fixed price. The underwriters indicated that they would not object to stabilization by the company provided that such stabilization was reasonable. At this point the parties adjourned to the following morning, February 3rd.

At about 10:35 A.M. on February 3, Kaiser-Frazer Corporation concluded to proceed with a stabilizing bid. Shortly thereafter it became evident that the stock was being offered by the public in great volume and Kaiser-Frazer Corporation then authorized its officers to continue to purchase, with the result that by 1:30 P.M. the company had purchased in excess of 100,000 shares of its stock. It then became apparent that the market would not go above the stabilizing bid of $13½ and Kaiser-Frazer Corporation offered to conclude a deal with the underwriters on the basis of an offering price to the public of $13. and a net to the company of $11.50.

The underwriters met at 2:45 P.M. to consider this proposal. The conference was still taking place when the

New York Curb Exchange closed at 3 P.M., at which
61 time the indications were that the company had purchased in excess of 180,000 shares of its own stock. Because of the unprecedented amount of such purchases and the indications that the investment public did not look favorably on Kaiser-Frazer stock, deponent then, as president of Otis & Co., concluded that the offering should not be attempted, and so advised the other underwriters. Deponent then informed the company of that decision, which left the company in the position of having spent more than $2,500,000. in the purchase of its own stock, without avail. To relieve the company of its embarrassment, deponent offered on behalf of the underwriters to purchase this stock from the company at its cost. However, more pressure was brought to bear upon him to go forward with some kind of offering and finally, relying upon various representations which later proved to be false, deponent agreed, subject to various conditions, to participate on the basis of an offering of 900,000 shares with the balance of 600,000 to be on option.

The agreement to that effect was executed about 5:30 P.M. on February 3. At about 6:00 P.M. the underwriters were advised that the registration statement had become effective and proceeded to endeavor to make the offering. In order to facilitate the offering, they undertook to stabilize for their own account on several exchanges at $13. per share, with the result that by approximately noon on February 4 they had purchased 45,900 shares of Kaiser-Frazer stock. They had sold, through their own efforts and those of the members of the selling group, less than
400,000 shares of the new offering. Thereafter the
62 underwriters terminated the offering to the public.

During the course of the day, news of the extraordinary stabilization of the company on the previous day circulated through the financial community and aroused widespread comment and criticism, much of it directed at the Commission both for clearing the registration state-

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ment with such haste and for permitting it to become effective in the face of these enormous purchases. The financial editor of the "New York Sun", commenting on a remark by Senator Tobey that the Commission was not without a measure of responsibility for this financial fiasco, called it "a masterpiece of understatement." Otis & Co. and the other underwriters received protests from dealers to whom participations in the offering had been offered or confirmed, and also received an inquiry from the Division of Securities of the State of Ohio as to whether dealers in that State would be required to accept the stock which they had agreed to purchase.

In view of this information and of other information received by Otis & Co. indicating that Kaiser-Frazer Corporation had not been frank with the underwriters and that the offering could not be safely proceeded with, either morally or legally, Otis & Co. and First California Corporation endeavored prior to the closing date of February 9 to work out some arrangement with Kaiser-Frazer Corporation which would take account of the circumstances. They were unsuccessful.

63 Almost too late, Otis & Co. discovered that the financial condition of Kaiser-Frazer had deteriorated and that the actual purpose of this third financing was to replace corporate funds which had been used in December 1947 to relieve Mr. Kaiser through his personal corporations and Mr. Frazer personally of their obligations on the note to which reference has already been made, rather than for the purpose stated in the registration statement. In other words, it became clear that the registration statement of Kaiser-Frazer Corporation was false and misleading and that the stock issue was to be a "bail out" operation in which the funds of the general public were to be used to pay off the personal obligations of Messrs. Kaiser and Frazer. In addition, the market for the securities had been pushed to an artificial level by false statements of the company's president and by other manipulative practices.

Shortly before the withdrawal of Otis & Co., a stockholders' suit was brought by James F. Masterson against the officers of the Kaiser-Frazer Corporation and the underwriters and others and on behalf of the shareholders of Kaiser-Frazer Corporation. This suit was only one of the many reasons for the withdrawal of Otis & Co. from the underwriting, which was done by a formal notice of termination served on Kaiser-Frazer on February 9, 1948 by the managing underwriters.

Kaiser-Frazer Corporation, immediately after Otis & Co.'s withdrawal, proceeded to move on three fronts. First, it began a suit against Otis & Co., now pending in the United States District Court for the Southern District of New York, for about $19,000,000. (originally $7,700,000.) damages for claimed breach of the underwriting contract, charging that Otis & Co. had inspired the Masterson
64 shareholder's suit. Second, it communicated in various ways with the Securities and Exchange Commission and officials thereof, making false and untrue charges and representations concerning Otis & Co., and induced the Commission to begin an investigation, not of all the circumstances of the stock issue, but only of its allegations concerning the shareholder's suit and other false allegations against Otis & Co. Third, it filed a complaint against Otis & Co. before the National Association of Securities Dealers. In aid of these attacks it fostered a wave of unfavorable publicity against Otis & Co. designed to injure the reputation essential to a sound banking institution.

On February 18, the Commission entered the usual order for a private investigation to determine whether any provision of the laws administered by it had been violated. A copy of that order is attached to the complaint as Exhibit "A". Although the scope of that investigation has never been completely revealed, the Commission indicated from time to time that investigators were traveling around the country obtaining records and statements. The ordinary conclusion to such an investigation would have been either

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a closing of the file because no violation of law had occurred or the commencement of a proceeding based upon charges and subject to all of the safeguards for those charges contained in the Administrative Procedure Act. The Commission did neither. It instead issued an order of March 23 for a so-called public investigation while at the same time disclaiming that the order was to be construed as indicating possible violation by anyone or that the investigation could result in any findings of violation. A copy
65 of the order of March 23 is attached as Exhibit "B" to the complaint herein.

In the course of the Securities and Exchange Commission "investigation" which followed, it became apparent that the reputation of Otis & Co. was to be assailed without the remotest semblance of a fair trial.

Deponent was present at only part of these hearings. Most of the sessions were attended by Mr. Harry Irwin, Assistant to the President of Otis & Co., and it is deponent's understanding that the said Harry Irwin will supply an affidavit concerning the conduct of the Commission's proceedings. Deponent further says that, as president of Otis & Co., not only from his own observations of part of these hearings, but from press reports, it is plain that the hearings had as their purpose and effect to injure and damage the reputation of Otis & Co. by press campaign conducted by the Commission. The Commission in its hearings fostered a campaign of false statements, derogatory to Otis & Co. and permitted the hearings to become a sounding board for all types of rumor and hearsay designed to attack Otis & Co. At the same time the Commission refused to investigate the illegal activities of Kaiser-Frazer despite formal motions by Otis & Co. seeking such action and proffers of proof in support thereof. It thus became clear that the Commission had a pre-determined purpose to injure Otis & Co.

Otis & Co.'s action in refusing to go through with an illegal and improper sale of securities protected the public

against having foisted on it a sale of securities by false representations and at manipulated prices. The Commission's investigation has shown that Otis & Co.'s action in terminating the contract protected investors from
66 loss and that no investor lost money. Nevertheless, the Commission has pursued Otis & Co. on the same allegations and on the same ground that is charged by Kaiser-Frazer in its law suit in New York. The Commission has given every evidence that its primary concern is with the charges made by Kaiser-Frazer and that it has no interest in enforcing the law impartially or inquiring into delinquencies of Kaiser-Frazer Corporation.

Otis & Co. is an investment banking house. Its continued success is dependent upon its good will and reputation. Its reputation is its principal asset. This the Commission undertook to destroy. The Commission's campaign has made it difficult for Otis & Co. to conduct its operations as an investment banking house. It has placed obstacles in the way of Otis & Co. in its underwriting and dealings in securities by expressed and implied threats to revoke Otis & Co.'s registration as a broker-dealer and by public attack on its reputation and character. Some persons otherwise willing to do business with Otis & Co. have, in all probability, refrained from doing so for fear of incurring the displeasure of the Commission because of the unfavorable publicity engendered by the Commission. Still others may have declined to do so as a result of the insistent intimations by the Commission that it intends to terminate Otis & Co.'s right to do business as an investment banker.

Although of lesser importance, the cost and expense already caused Otis & Co. by these proceedings should not be left out of account. For the transcript of the so-called public investigation alone Otis & Co. incurred an expense of more than $14,000. In addition, there was the cost
67 of legal representation in those hearings held at different times in eight cities ranging from New York to Los Angeles, as well as the time and expense of both preparation and attendance on the part of plaintiff's officers

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and employees. The action before Judge Morris was likewise difficult and costly, made all the more so by the conduct of the Commission which, for example, compelled Otis & Co. to apply to the Court merely to obtain time to prepare its defense. Considerable expense was likewise involved in the proceedings which resulted in the grant of a stay by Judge Letts. It is evident that the indefinite prolongation of proceedings of this character can result in a situation where few persons would, and not many could, maintain a contest with a government agency determined to vindicate its prestige at whatever expense to others.

Although Judge Morris has ruled that the Commission's conclusion on the facts cannot be sustained, the Commission has not filed a notice of appeal from Judge Morris' decision, and, on information and belief, does not intend to file an appeal. The Commission instead has set down a hearing for November 15th, in its own forum, at which it proposes to examine into the question of whether Mr. Eaton inspired the Masterson suit. The Commission has already predetermined that it will adhere to its announced conclusion that the Masterson suit was so inspired despite Judge Morris' contrary judgment and despite the fact that no appeal is intended to be taken from that judgment.

Such action by the Commission will, if permitted
68 to be carried out, cause Otis & Co. irreparable injury.

1. It will subject Otis & Co. to the expense of time-consuming litigation of matters already determined against the Commission by Judge Morris, an expense which may be reasonably be expected to exceed $50,000.00.

2. It will subject Otis & Co. to further adverse publicity by the further public airing of the Commission's charges in a forum antagonistic to Otis & Co. and in a manner designed to create the greatest possible adverse publicity to the Commission's unfounded charges that the Masterson suit was inspired. Such publicity is extremely damaging to a banking house whose principal asset is its reputation.

3. The predetermined and predestined conclusion, despite Judge Morris' ruling, will be to the effect that Mr.

Eaton did in fact inspire the Masterson suit, which false conclusion will injure Otis & Co. in defending itself against the identical charge of inspiration of the Masterson suit in a pending law suit by Kaiser-Frazer Corporation for $19,000,000. Judge Morris' decision has made it clear that there is no basis to the charge that the Masterson suit was inspired. It is the Commission's hope, by circumvention of that decision and collateral attack on it, to give aid and comfort to Kaiser-Frazer in its private suit against Otis & Co. for $19,000,000. Such a decision by a supposedly impartial, though in fact biased and prejudiced Commission, would involve substantial and perhaps irreparable injury to Otis & Co. in its defense of the Kaiser-Frazer litigation in New York. The Commission cannot do justice to Otis & Co. in any hearings in which it is required to judge facts and law since it has already predeter-
69 mined all the facts and law against Otis & Co. The Court should require the Commission to refrain from taking such action, at least unless and until it has filed an appeal from Judge Morris' order and has obtained a reversal of that judgment.

WILLIAM R. DALEY.

* * * * * * * * * *

71 Filed Nov 12 1948

Motion to Dismiss Complaint

The defendants move this Honorable Court to dismiss the complaint herein on the grounds (a) that the Court lacks jurisdiction over the subject matter and (b) that the complaint fails to state a claim against the defendants upon which relief can be granted. The grounds are more fully stated in the Memorandum filed herein.

LOUIS LOSS,
Associate General Counsel,
Securities and Exchange Commission.

* * * * * * * * * *

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106 **Filed Nov 12 1948**

Affidavit of Harry W. Irwin

CITY OF WASHINGTON, *District of Columbia*, ss:

I, Harry W. Irwin, being duly sworn, depose and say:

I am assistant to the President of Otis & Co.; I have attended the sessions of the public hearings of the Securities and Exchange Commission in its public investigation entitled In the Matter of the offering of the stock of Kaiser-Frazer Corporation. I have followed the sessions all over the United States and have heard all the testimony with the exception of two days in Cleveland, and I have read the testimony taken on those days.

The Commission's investigation placed principal emphasis on the charge that a law suit filed in Detroit entitled Masterson v. Kaiser-Frazer, et al. was inspired by Cyrus S. Eaton as a means of avoiding an underwriting agreement dated February 3, 1948 between Otis & Co. and Kaiser-Frazer Corporation. This charge is identical with the charge made by Kaiser-Frazer Corporation in a suit against Otis & Co. for $19,000,000. In the conduct of its investigation, the Commission and its employees have, at

107 all times, conducted their inquiry in a most adversary spirit against Otis & Co. The hearings were conducted as a press campaign against Otis & Co., designed to convince the public through the press that Otis & Co. was guilty of the charge made against it by Kaiser-Frazer Corporation and that Mr. Eaton was guilty of inspiring the Masterson suit. The Commission used every dramatic trick possible to attempt to insinuate guilt. It placed people on the stand who had no knowledge whatsoever concerning the Masterson suit and permitted them to express opinions that the suit was collusive and that it had been inspired by Mr. Eaton. On the other hand, relevant evidence tending to show that the suit had not, in fact, been inspired by Mr. Eaton, was excluded by the Commis-

sion. Counsel for Otis & Co. were given no opportunity to cross-examine witnesses. Evidence, statements, opinions, rumors and hearsay to the effect that Otis & Co. was guilty of inspiring the law suit were accepted with satisfaction and complacency by Commission counsel and subjected to no examination whatsoever.

On the other hand, all testimony tending to show that the law suit was not inspired was greeted with incredulity. Every attorney who had ever been retained during this period by Otis & Co. or Mr. Eaton was subjected to the most exhaustive, repetitious questioning by Commission counsel in such a way as to indicated that Commission counsel were firmly convinced that they were all participants in inspiring the Masterson suit. Clear and specific denials of any such participation were received with open skepticism and disbelief; questions were rephrased to have the testimony repeated again and again. Failing in this attempt, Commission counsel asked the same questions with a preface in such a form as would require the disclosure of confidential communications between attorney and client.

Since counsel were naturally under obligation to re-
108 fuse to answer such questions, much publicity was made by the Commission of the refusal to answer such questions. Public demands were made for waiver of the attorney-client privilege in violation of law and justice, but in such a manner as to create publicity adverse to Otis & Co.

As a result of this press campaign of the Commission, the Commission's views that Mr. Eaton had, in fact, inspired the Masterson suit, were given wide currency in the press and many stories stating or implying this were published at the Commission's instigation and as an intended result of its public investigation. Furthermore, the Commission in these hearings on June 3, 1948, directed its hearing officer to announce that the Commission had found that the law suit had, in fact, been inspired. Thereafter in a complaint filed in this Court accompanied by a press re-

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lease, the Commission reannounced its conclusion that the Masterson suit had been inspired by Mr. Eaton and in its brief and oral argument announced sweeping determinations of fact and law which completely prejudge the issue purportedly to be determined in the new administrative proceeding. The Commission has thus committed itself completely, publicly and openly to the thesis that Otis & Co. is guilty. It has refused to accept Judge Morris' decision that its record contains no such proof and instead is seeking to avoid the force of his decision by holding a hearing before the Commission itself where its decision will never be in doubt. It does not dare to appeal from Judge Morris' decision. It is unwilling to submit itself and its predetermined conclusions to the impartial judgment of a court and is seeking instead further publicity by repeating in new hearings the charges against Otis & Co., where it will have control of the conduct of the proceeding and give out the publicity which is issued.

109 Lest the Court believe that I am exaggerating the effect of the publicity campaign of the Commission, I must explain that the public investigation was not, in fact, an investigation to discover facts. It was a dramatic presentation of facts which had long before been discovered by the Commission in a private investigation. With few exceptions, every witness had talked to the Commission and the Commission had a written account of his testimony. The Commission itself and members of its staff were in constant communication with the press. Even such minor matters as the nature and date of future hearings were obtained by representatives of Otis & Co. from the press, while Commission staff members were unwilling to reveal this information directly to representatives of Otis & Co.

Perhaps the clearest example of the Commission's framing of the hearings as a dramatic presentation rather than an investigation is the testimony taken in Detroit on May 5. Allan Hull, an attorney for Mr. Eaton, had been subpoenaed to testify not in his home city of Cleveland, in

which the Commission held some of the hearings, but in Detroit. He had not been previously interviewed by the Commission. Due to other engagements he was unable to attend the hearings until the evening of that day.

The Commission put on a series of witnesses who testified that inquiry had been made at the Court in Detroit concerning suits against Kaiser-Frazer Corporation by an unidentified individual. The Commission obviously knew that the individual was Mr. Hull for they had subpoenaed him and had telephone slips with his name on them. Yet they took all their witnesses through an exhaustive description of the man who had been at the Court House—
the clothes he wore, his height, his weight, his glasses
110 and his mustache. Naturally the press played up in
big headlines the "MYSTERY MAN" at the Securities and Exchange Commission investigation. When Mr. Hull appeared on the stand, the mystery was exploded. He testified clearly and simply concerning his visit to the Court House and his activities there. Nevertheless, the Securities and Exchange Commission proceeded as if Mr. Hull had denied his identification as the person in question, and recalled some of the earlier witnesses to identify Mr. Hull as the visitor to the Court House. The testimony of these witnesses was at that point superfluous corroboration of Mr. Hull's testimony designed to create an atmosphere of criminality.

The Commission has never explained nor can it explain why it prepared this elaborate drama. Its purpose can only have been to smear Otis & Co. and Mr. Eaton in the press. Certainly if the Commission was seeking facts it could have obtained those facts quite readily by an interview with Mr. Hull before he took the stand in Detroit. It is clear that the Commission was interested in no mere dull pursuit of the truth. It wanted a drama in headlines which could be turned against Otis & Co.

Similarly, the Commission has not undertaken to explain, nor can it satisfactorily explain, why, for the first time in

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its history, it denied Otis & Co. the opportunity of cross-examination of the witnesses called in this public investigation.

The Commission's conduct of the court action which it instituted to compel two of Mr. Eaton's attorneys to testify to their confidential communications with their client has been characterized by the same zeal for adverse publicity against Otis & Co. which marked its own investiga-
111 tion. Not content with releasing to the press copies of its complaint, replete with accusations of fraud, the Commission prepared and released to the press a special press release, in a successful effort to ensure that these charges should receive ample press coverage. Instead of offering to the Court the record of the investigation, the Commission attempted to proceed upon an affidavit of its prosecutor which purported to set forth what the record showed but was in fact a biased, distorted and untruthful version thereof. Characteristically, the Commission's press release called attention to this affidavit, which has received the widest publicity. It was only after repeated challenges to this affidavit that the Commission reluctantly submitted the actual record in lieu thereof.

I come now to the proceeding instituted by the notice and order of August 11, 1948. An announcement that proceedings will be held to determine whether the license of an investment banker to do business should be revoked, is fraught with the gravest consequences to the person affected, regardless of the eventual outcome. The Commission itself appeared to recognize this fact and, in the printed brief which it submitted to Judge Morris, it represented that the purpose of the action was to obtain testimony to enable the Commission to determine whether the institution of such a proceeding would be warranted. Nevertheless, without explanation and without notice to either the Court or the parties, the Commission commenced the proceeding while the Court still had the issues under advisement. The commencement of this proceeding was of course diligently circulated to the press.

Upon inquiry by Otis & Co. it was advised by the Commission that the latter intended to proceed with its
112 hearing on September 20 "without regard to" whether Judge Morris had ruled by that time, and the Commission strenuously opposed the application before Judge Letts for a stay, but at no time undertook to offer any reason for its haste, or to explain its unwillingness to await a decision on these very matters in the action which it itself had commenced. It seems inescapable that the representation made in the brief to Judge Morris was a sham, and that it was the Commission's intention to institute such a proceeding and to attempt to put Otis & Co. out of business regardless of whether the attorneys were ordered to testify, or of the nature of their testimony if obtained.

The order of Judge Letts restrained the Commission from proceeding until decision by Judge Morris. The latter filed his memorandum on October 18 stating his disposition of the issues and directing the submission of appropriate orders. Counsel appeared before Judge Morris on the afternoon of October 28, 1948 to settle the order and judgment in the action. That same afternoon the Commission announced that hearings would commence in its proceeding on November 15, releasing this announcement to the press before it served a copy on counsel for Otis & Co.

The Commission had announced that it would place in the record of its public investigation "all the relevant facts" and it has exhaustively probed, without avail, every possible avenue which could indicate that Otis & Co. and Mr. Eaton had any connection whatever with the Masterson suit. The record makes it clear that the Commission has no evidence in addition to or other than the matters presented in the record which was introduced in the proceeding before Judge Morris. On this record, the court determined that the Commission has no case. The
113 Commission, nevertheless, is seeking to harrass Otis & Co. further by the reiteration of all this testimony, and to injure Otis & Co. by constant adverse publicity.

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The Commission's attitude, I submit, must be judged in the light of the fact that the Commission has been subjected to substantial criticism in the press and in the Congress for its action in clearing the Kaiser-Frazer registration statement containing false and misleading statements and in approving the "stabilization" of Kaiser-Frazer stock, a "stabilization" which has been held by a Federal Court to be an unlawful manipulation.

In order to protect its position in this respect the Commission has gone to great lengths. In a private suit by an investor against Kaiser-Frazer Corporation's directors the Commission has intervened not on behalf of the investor, as is its usual role, but for perhaps the first time in its history on behalf of a corporate management. It sought but failed to obtain a court ruling that Kaiser-Frazer's purchases of stock were legal stabilizations. See opinion in Stella v. Kaiser, S. D. N. Y., No. 45-750, opinion of August 2, 1948 per Leibell, J.

The Commission has arrived at a position where it evidently regards it as a matter of prestige to show that Otis & Co. which protected investors was wrong, and that the Commission which approved a scheme to injure investors was right. Unless enjoined, the Commission will not stop its campaign to retry Otis & Co. in the press at great expense to Otis & Co. and to the government.

HARRY W. IRWIN.

* * * * * * * * * *

177 **Opinion of the Court**

THE COURT (Morris, J.): Well, gentlemen, the Court feels that the decision in this Court in the subpoena enforcement proceeding was necessarily based on the record that this Court considered in that proceeding. There is not any question of doubt that this Court had jurisdic-
178 tion to pass upon that question.

The Court considers that its decision in that proceeding, unless appealed from and reversed, is binding on the parties thereto. I do not think it can be said that that adjudication undertook to settle what would have been the situation had the record been different from that which the Court considered.

I think the law is too well settled, beyond dispute, and in fact, it was not seriously contested by either party, that the measure whether the attorney-client privilege can be pierced is whether or not there has been a showing of evidence outside of the communications, which would justify a finding of fraud, a finding of fraud by me. Not that this Court holds that there was or was not fraud, but whether there was evidence showing, if it went to a finding and authority, which did find fraud, and that it could be sustained.

It was on that record that this Court held that that showing hadn't been made. That certainly is not to say that if a showing is made of fraud, that the attorney-client privilege could not be pierced.

The Court undertook to perform its duty imposed on it by statute when it acted in that manner. In that same proceeding it was asked to enjoin those proceedings, and, of course, declined to do it.

179 If anything can be said to be res judicata, it is that this Court settled that those proceedings would not be enjoined, but that does not settle the question here.

Those are proceedings brought by the Commission under authority that I do not believe has been questioned. It is not in this proceeding that the Commission cannot proceed towards the revocation of licenses, and with respect to such proceedings, there is a plain, explicit procedure of statutory review.

Now, I think the Myers case, the Waterman Steamship Company case, and the Federal Power Commission against Arkansas Light & Power Company case, and expressions in other cases, make it so abundantly clear that a court of equity should not interfere in the administrative pro-

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ceedings where there is a plain and adequate statutory right to judicial review.

That is not to say that there cannot be circumstances that would alter the application of that rule.

I just said from the bench a few minutes ago that if an effort were made to flout or disregard the order of this Court made pursuant to its statutory jurisdiction, that I would not consider these cases to stand in the way of enforcing the order of this Court. But that is not what has been made to appear here to me today. If there is a basis for the contention that it is res judicata here, it can most assuredly be asserted after the administrative proceedings and before it becomes effective under the statutory judicial review by a Court of Appeals.

For me to speculate here on whether or not there is going to be a different record, or whether they are going to depend upon the same kind of evidence that was submitted in the subpoena enforcement proceedings, is perfectly futile.

It is trying, as I said last week in the Federal Reserve System case against Transamerica, it is trying to decide these cases in vaccuo, and that is one of the principal reasons that stands behind the rule for the exhaustion of administrative remedies, and the consideration by the administrative agency of the matter before it is considered on judicial review. It is like the Court of Appeals trying to settle questions before the trial court hears it.

The injunction will be denied and the motion to dismiss will be granted.

• • • • • • • • • • •

114 Filed Nov 12 1948

Judgment

Plaintiff having made a motion for a temporary injunction restraining defendants from considering certain issues in an administrative proceeding to determine whether the registration of Otis & Company and another as broker-dealers should be revoked, and defendants having made a

cross motion for dismissal of the complaint, upon consideration thereof,

It Is Ordered that the motion of plaintiff be and the same hereby is denied, and that the complaint be and the same hereby is dismissed.

Jas. W. Morris,
District Judge.

Dated: Nov. 12, 1948.

Approved as to form:

Abe Fortas,
Counsel for Plaintiff.

Louis Loss,
Counsel for Defendants.

* * * * * * * * * *

115 Filed Nov 12 1948

Notice of Appeal

Notice is hereby given that plaintiff in the above-entitled action hereby appeals to the Court of Appeals for the District of Columbia from the order of this Court dated November 12, 1948, denying the motion for injunction pendente lite in the above-entitled action, and dismissing the complaint.

Arnold, Fortas & Porter.

By Abe Fortas,
1200 18th Street, N. W.,
Washington 6, D. C.,
Attorneys for Plaintiff.

* * * * * * * * * *

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STATEMENT ON POINTS OF APPEAL

1. The court below erred in failing to rule that the judgment between the parties in Civil No. 2617-48 in the United States District Court for the District of Columbia was *res judicata* of the issue of whether Appellant instigated the Masterson suit and barred inquiry by Appellee SEC into that issue in its scheduled administrative proceeding before itself.

2. The court below erred in ruling that it had no jurisdiction to grant injunctive relief, as prayed in the complaint, against reconsideration of that issue in Appellee SEC's scheduled administrative proceeding.

3. The court below erred in failing to rule that Appellant had established that it would suffer irreparable injury from the reconsideration of that issue by Appellee SEC.

4. The court below erred in failing to grant the relief prayed by Appellant to enjoin Appellee's scheduled administrative proceeding with respect to that issue.

5. The court below erred in dismissing the complaint.

United States Court of Appeals for the District of Columbia Circuit. Filed Nov. 12, 1948. Joseph W. Stewart, Clerk.

IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

No. 10058

OTIS & CO., APPELLANT

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL., APPELLEES

Motion for Stay

Appellant moves this Honorable Court for a stay of the proceedings by the Securities and Exchange Commission pursuant to its Orders of August 11, 1948 and October 28, 1948, insofar as they purport to be taken pursuant to said orders and to inquire into the alleged termination of an underwriting agreement and alleged instigation of a lawsuit entitled *Masterson* v. *Kaiser-Frazer*. As reasons therefor, appellant states as follows:

1. The Securities and Exchange Commission is proposing to commence a hearing on November 15, 1948. In this hearing the Commission proposes to take evidence and to decide an issue which

has been litigated by the appellant and the Commission in a previous action and has been determined against the Commission. This previous action is res judicata of the issues which the Commission proposes to try. Despite the fact that the issue is res judicata the Commission proposes to conduct a hearing at which all the evidence which was before the District Court and which resulted in the judgment of that Court against the Commission will be represented and retried.

2. It is illegal and improper for the Commission to hold such hearing while the judgment of the District Court remains unmodified and unreversed.

3. To hold such hearing would subject appellant to substantial vexation and expense of extensive litigation on a matter which is res judicata. As shown by the affidavits below the expense will exceed $50,000. In addition adverse publicity will result which will injure the reputation of appellant as an investment banking concern.

4. No harm or injury will occur to the Commission by postponing the hearing until this Court has passed upon the substantial and real questions presented by this appeal. Otis & Co. is a banking house of substantial assets and many years standing. If any punishment is to be imposed upon them it can be imposed at a later date as well as presently.

If the Commission is permitted to proceed with its hearings, the injury will already have been done to Otis & Co. and the appeal to this Court will be rendered fruitless and moot.

Otis & Co. requests that the status quo be maintained until it has had an opportunity to present to this Court the issues on appeal.

Respectfully submitted,

ARNOLD, FORTAS & PORTER,
By ABE FORTAS,
1200 18th St., N.W.,
Washington 6, D. C.,
Attorneys for Appellant.

Service made by delivery of Copy to L. Loss, Esq., Counsel for Appellees, Nov. 12, 1948.

MILTON V. FREEMAN.

United States Court of Appeals for the District of Columbia Circuit—Filed Nov. 12, 1948. Joseph W. Stewart, Clerk.

In the United States Court of Appeals for the District of Columbia Circuit

No. 10058

OTIS & CO., APPELLANT

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL., APPELLEES

Before CLARK, WILBUR K. MILLER and PRETTYMAN, JJ.

Order for Injunction

On motion of counsel for appellant Otis & Co., and counsel for appellant and appellees having been heard, and it appearing that appellees Securities and Exchange Commission have issued a notice for hearing on November 15, 1948, and that unless restrained action may be taken in that hearing injurious to appellant, and it further appearing that it is necessary to maintain the status quo pending full hearing on the appeal filed herein,

It is hereby ordered, adjudged and decreed that pending the decision of this Court on appeal, the Securities and Exchange Commission be and it is hereby enjoined from

(a) proceeding pursuant to the Commission's orders of August 11, 1948 and October 28, 1948, insofar as those orders relate to or involve the termination of the underwriting agreement between plaintiff and Kaiser-Frazer Corporation, or the alleged instigation of a stockholder's derivative suit for the alleged purpose of avoiding plaintiff's obligations.

(b) taking any evidence, compelling attendance at hearings, or taking any action whatsoever, with respect to the above matters.

(c) The appeal is advanced for hearing: appellant's brief to be filed by November 26, 1948; appellee's brief by December 10, 1948; and any reply brief by December 14, 1948.

Per Curiam.

November 12, 1948.

United States Court of Appeals for the District of Columbia Circuit. Filed Jun. 1, 1949. Joseph W. Stewart, Clerk.

United States Court of Appeals for the District of Columbia Circuit

No. 10,058

OTIS & COMPANY, APPELLANT

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL., APPELLEES

Appeal from the United States District Court for the District of Columbia

Argued December 17, 1948. Decided June 1, 1949

Messrs. Thurman Arnold and *Joseph L. Weiner*, with whom *Abe Fortas*, *Milton V. Freeman* and *Norman Diamond* were on the brief, for appellant.

Mr. Louis Loss, Associate General Counsel, Securities & Exchange Commission, with whom *Messrs. Edward H. Cashion*, *E. Russel Kelly*, *C. J. Odenweller, Jr.*, and *Alfred Hill*, Attorneys, Securities & Exchange Commission, were on the brief, for appellees.

Before STEPHENS, C. J., and WILBUR K. MILLER and PROCTOR, JJ.

WILBUR K. MILLER, J.: Otis & Company, an investment banking house, was one of three underwriters which contracted to purchase an issue of common stock of Kaiser-Frazer Corporation. Among the conditions precedent in the underwriting agreement was that on February 9, 1948, the closing day, there should be no material litigation pending against Kaiser-Frazer. On the morning of that day, and before the purchase of the stock had been consummated, one Masterson sued Kaiser-Frazer in a state court in Detroit, seeking to enjoin the contemplated sale. Assigning the pendency of that suit as one of its reasons for so doing, Otis cancelled the underwriting contract.

On February 13, 1948, Kaiser-Frazer sued Otis in a New York state court charging that it had fraudulently caused Masterson to file the Detroit suit in order to terminate the underwriting agreement.

Five days later the Securities and Exchange Commission ordered its staff to make what it termed a "private investigation" to determine whether certain anti-fraud provisions of the Securities and Exchange Act of 1934 had been violated by the underwriters. Thereafter, and on March 23, 1948, the Commission ordered a public investigation to be made. Pursuant to that order extensive hearings

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were conducted at which Otis was allowed to observe but was not permitted to cross-examine witnesses nor to introduce evidence.

It was indicated during the investigation that Otis or Cyrus S. Eaton, its controlling stockholder, had consulted Harrison and Hull, attorneys at law of Cleveland, Ohio, concerning the Masterson suit. Because of that indication the Commission subpoenaed Harrison and Hull, who declined to give the name of their client until compelled to do so by the United States District Court at Detroit after the Commission instituted therein a subpoena enforcement proceeding. They then disclosed that their client was Eaton. After much additional evidence had been taken in various cities, the investigation was reconvened in Washington and Harrison and Hull were again called as witnesses. They refused, on the ground of attorney-client privilege, to testify concerning the communications between them and Eaton. The Commission directed its presiding officer to rule that evidence already received made a prima facie showing that Eaton had consulted the attorneys concerning the perpetration of a fraud, and that therefore the attorney-client privilege was unavailable. Harrison and Hull continue to decline to answer.

Following this, and on June 25, 1948, the Commission filed a complaint in the United States District Court for the District of Columbia praying that Harrison and Hull be required to appear before the Commission or its hearing officer to answer questions concerning conversations between them and their client, and their activities in his behalf relating to the subject matter of the investigation, and any other questions material to the investigation except those the answers to which might be self-incriminatory. Eaton and Otis were permitted to intervene.

The Commission recited in the complaint its belief that evidence in the record of its public investigation amounted to a prima facie showing that Eaton had consulted the attorneys in connection with the filing of a collusive and fraudulent lawsuit. In support of its complaint, the Commission filed the affidavit of one of its staff which purported to set forth the evidence in the record regarded by the Commission as establishing the prima facie fraud. Later the Commission offered the entire record of its public investigation, the transcript of which contained more than five thousand pages.

After extensive argument, District Judge Morris filed an opinion in which he held that the evidence which was before the Commission and before him, together with all reasonable inferences to be drawn therefrom, did not make "the requisite *prima facie* showing of fraud to pierce the attorney-client privilege . . ." Accordingly the District Court ordered, on October 28, 1948,

> ". . . That the order sought by the plaintiff Securities and Exchange Commission to enforce the subpoenas directed to the defendants in so far as they call for testimony and evidence

relating to communications with their client Cyrus S. Eaton or require a disclosure of such communications be and it is hereby denied, . . ."

After the case had been argued before Judge Morris, but long before he had decided it, the Securities and Exchange Commission on August 11, 1948, entered an order entitled "In the matter of Otis & Company, 2000 Terminal Tower Building, Cleveland, Ohio", which recited at length the history of the underwriting agreement, and which included the following:

"The Commission, as the result of a public investigation, has obtained information which tends, if true, to show that:

* * * * *

"H. The underwriting agreement provided that it could be terminated by the underwriters if at the time for settlement any material litigation were pending or threatened against K-F, except as disclosed by the registration statement. For the purpose of evading its obligations under the underwriting agreement through this provision, the registrant through Eaton caused a lawsuit against K-F to be filed on February 9, 1948, before 10:00 A. M. in the Circuit Court for the County of Wayne, Michigan. At the time and place for settlement the registrant refused to consummate the underwriting agreement and asserted that it was released from its obligations thereunder because of the lawsuit. The registrant omitted to state to K-F, the co-underwriters, and purchasers that it had caused the said lawsuit to be filed."

The order of August 11 directed that for the purpose of determining whether to suspend or expel Otis from membership in the National Association of Securities Dealers, Inc., a hearing before the Commission or its designated officer be held on September 20, 1948. Upon the application of Otis and Eaton, Judge Letts of the District Court enjoined the Commission from taking any action whatever pursuant to its order of August 11, 1948, pending the decision of Judge Morris. A portion of the recital of Judge Letts' order was as follows:

". . . it appearing that the holding of such a hearing may involve interference with the jurisdiction of this Court in the above entitled matter, and it further appearing that it is necessary to protect the jurisdiction of this Court,

"It is hereby ordered, . . ."

That injunction expired by its terms on October 28, 1948, when Judge Morris entered a final order. Within a few hours after its

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entry, the Commission activated its order of August 11, 1948, by directing that a hearing commence on November 15, 1948,

> ". . . to determine whether to revoke or suspend the broker-dealer registration of Otis & Company, and whether to suspend or expel the said company from membership in the National Association of Securities Dealers, Inc., . . ."

On November 10, 1948, Otis sued the Commission in the United States District Court for the District of Columbia to enjoin it from proceeding pursuant to its orders of August 11 and October 28, 1948,

> ". . . insofar as those orders relate to or involve the termination of the underwriting agreement between plaintiff and Kaiser-Frazer Corporation, or the alleged instigation of a stockholder's derivative suit for the alleged purpose of avoiding plaintiff's obligations under said underwriting contract; . . ."

It prayed

> "That the Court declare that the judgment of this Court of October 28, 1948, is binding as *res judicata* on the defendant Commissions and that it is without power to conduct the proposed inquiry into the alleged instigation of the Masterson suit."

The complaint related the story of the whole matter and, with respect to the hearing set for November 15, contained the following allegation:

> "27. In said hearing the Commission proposes to reintroduce the evidence obtained by it in the so-called public investigation which it has already held to constitute *prima facie* proof that the Masterson suit was inspired by plaintiff through said Eaton, and again to pass upon that evidence. The Commission proposes to do this despite the fact that this Court, through Judge Morris, has determined that such evidence does not constitute even a *prima facie* showing thereof. On information and belief, plaintiff alleges that the Commission does not have and cannot produce any evidence in addition to that in the record of its so-called public investigation which has heretofore been passed upon by this Court. (The Commission's order of August 11, 1948, contains allegations not considered in the S. E. C. action; as to those matters no relief is here sought if properly severed for hearing.)"

The Commission moved to dismiss the complaint on the ground "(a) that the Court lacks jurisdiction over the subject matter and (b) that the complaint fails to state a claim against the defendants upon which relief can be granted." The District Court dismissed the complaint and this appeal followed.

The applicability of the doctrine of res judicata is therefore the determining factor in the case. Stated generally, that doctrine is that a right, question, or fact which is a ground of recovery and which was distinctly put in issue and directly determined by a court of competent jurisdiction, cannot be disputed in a subsequent suit between the same parties or their privies; and though the second suit be on a different cause of action, the right, question or fact determined in the first action must be taken as conclusively determined between the same parties and their privies, so long as the judgment in the first suit remains unmodified.[1]

In ascertaining whether the doctrine of res judicata is applicable here, we must see whether (a) the parties are the same; (b) whether the question of fact involved in the Commission's proposed hearing [2] was distinctly put in issue before the District Court in the subpoena enforcement suit and, if so, whether it was directly determined by the court.

The parties are, of course, the same; for in the suit against Harrison and Hull, the Commission was plaintiff and Eaton and Otis became parties by intervention, and in the proceeding proposed by the Commission in its orders of August 11 and October 28, Otis is the respondent and the Commission itself is the complainant.

In determining whether the issue decided by the District Court in the subpoena enforcement case is the same issue which the Commission desires to relitigate before itself, confusion will be avoided if care is used in distinguishing between the question which was actually before the court and a somewhat kindred question which was not before the court; and in ascertaining and defining the issue which the Commission desires to consider in a new hearing.

As to the latter, the appellee says in its brief that "The issue in the pending administrative proceeding . . . is whether the appellant has in fact been guilty of fraudulent conduct in connection with the filing of the Masterson suit." The statement is incorrect. It ignores the allegation of the complaint to the effect that the Commission will have no new evidence and that, therefore, the issue in the pending administrative proceeding is whether the evidence taken in the prior public investigation showed that the appellant was in fact guilty of fraudulent conduct in connection with the filing of the

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[1] *Tait* v. *Western Maryland Railway Co.*, 289 U. S. 620, 623 (1933); *United States* v. *Moser*, 266 U. S. 236, 242 (1924); *Deposit Bank of Frankfort* v. *Board of Councilmen of the City of Frankfort*, 191 U. S. 499, 514 (1903); *Southern Pacific Railroad Co.* v. *United States*, 168 U. S. 1, 48-49 (1897).

[2] That question of fact is, did the record of the Commission's public investigation contain substantial evidence showing that either Eaton or Otis fraudulently inspired the Masterson suit?

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Masterson suit. The appellee's misunderstanding of the question before the court when the motion to dismiss was considered, is further evidenced by this statement in its brief:

> "The fact is, of course, that, regardless of what the appellant alleges in its complaint as to the availability of new evidence, no one can say at this time what evidence will be introduced in the adversary administrative proceeding."

Quite to the contrary, the allegation of the complaint that no new evidence would be available at the adversary administrative proceeding must be accepted as true, for the purpose of considering the motion to dismiss.

The District Court in its opinion in the subpoena enforcement action succinctly stated the issue before it when it said,

> "The Court, in these proceedings, is not required, nor would it be proper, to make findings as to whether or not the fraud charged was perpetrated, but only to determine whether or not the evidence in the record, without more, constitutes a *prima facie* showing of such fraud."

We approve and emphasize the trial judge's determination that the issue of fraud *vel non* on the part of Eaton or Otis in connection with the Masterson lawsuit was not before the District Court in the subpoena enforcement proceeding. The quite different question, which was squarely presented and distinctly determined in the negative, was this: did the record of the Commission's public investigation contain prima facie evidence that the Masterson suit was fraudulently inspired by Eaton or his company? This clear distinction between what was not decided by the court in the subpoena enforcement case and what actually was decided there is of paramount importance here, although in argument it was often ignored or treated as immaterial.

With the true issue decided by the court thus recognized and isolated, it becomes necessary to find whether the Commission intended in its new hearing to re-examine the question whether its public investigation had developed proof of the fraud which it charged against Otis and Eaton, in the face of the court's ruling that that evidence did not make a prima facie showing of such fraud. The answer is to be found in the complaint and its exhibits. The Commission's order of August 11, which is one of the exhibits, contains the following:

> "The Commission, as the result of a public investigation, has obtained information which tends, if true, to show that:

* * * * *

> "H. . . . For the purpose of evading its obligations under the underwriting agreement through this provision, the registrant [Otis] through Eaton caused a lawsuit against K-F to be filed on February 9, 1948, before 10:00 A. M. in the Circuit Court for the County of Wayne, Michigan",

and continues by saying the Commission deems it necessary and appropriate that proceedings be instituted to determine whether the statement just quoted, among others, is true; and to determine whether it is necessary or appropriate to suspend or expel Otis from membership in the National Association of Securities Dealers, Inc.

It is thus apparent from its order that the Commission intended and intends to examine the question of fraud. It is moreover established by the pleadings that in its projected reconsideration of the fraud question, the Commission proposes to re-introduce the evidence obtained by it in its public investigation, and that the Commission does not have and cannot produce any evidence in addition thereto, since the appellant's allegation to that effect is admitted by the Commission's motion to dismiss the complaint.

Under the doctrine of res judicata, it must therefore be regarded as established, as between Otis and the Securities and Exchange Commission, that the evidence gathered by the Commission in its public investigation did not and does not amount to a prima facie showing that either Eaton or Otis fraudulently caused the Masterson suit to be filed.

It is beside the point to say in argument, as does the Commission, that there may be additional evidence and that the allegation of the complaint to which we have referred is "a remarkable bit of clairvoyance on the appellant's part". Be that as it may, it is alleged and not denied that the Commission does not have and cannot produce any additional evidence so, on the motion to dismiss, the District Court was confronted with a complaint which clearly showed the Commission about to determine anew an issue already decided by the court's valid and subsisting judgment. Consequently, instead of being immaterial as the Commission asserts, the uncontroverted allegation that there will be no more evidence is of extreme importance in this case, as it sharply shows that the Commission is about to examine the identical evidence considered by the court with respect to the alleged fraud in the Masterson suit.

Under circumstances such as those in this case, the exact question answered by the District Court in the subpoena enforcement proceeding could not be re-examined, in a suit between the same parties, by that or any other court. Whether it can be done by an administrative body is a question to which we now turn.

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One of the reasons assigned by the appellee for its contention that the doctrine of res judicata does not apply here is its theory that the *Myers* case [3] and subsequent Supreme Court decisions

> ". . . most assuredly set up a different rule to govern the relationship between courts and administrative agencies from the traditional rule which (subject to the important limitation in Section 265 of the Judicial Code) governs the relationship of courts among themselves."

As we read this portion of the appellee's brief, the argument is that, although a federal court has power to protect its decrees by enjoining relitigation of the same issues in another court, the Supreme Court has held a federal court does not have power to protect its decrees by enjoining relitigation of the same issues by an administrative agency. The paragraphs of the appellee's brief from which we deduce that its contention is as we have just stated are shown in the margin.[4] As

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[3] *Myers* v. *Bethlehem Shipbuilding Corp.*, 303 U. S. 41 (1938).

[4] "As a matter of fact, even *within* the judicial system, the Supreme Court recently held that the power of a federal court to protect its decrees by enjoining relitigation of the same issues elsewhere is qualified by an important exception in the form of Section 265 of the Judicial Code (36 Stat. 1162, 28 U. S. C. § 379), which prohibits the staying of proceedings in state courts. *Toucey* v. *N. Y. Life Insurance Co.*, 314 U. S. 118 (1941). The *Myers* doctrine rests upon generally similar considerations; for it recognizes that, in the familiar statutory provisions vesting primary regulatory jurisdiction in administrative agencies and exclusive review jurisdiction in designated courts, the Congress, no less than in Section 265 of the Judicial Code, has evinced an intention to render inapplicable the traditional remedy of the injunction. It is noteworthy that both in the *Toucey* case and in the *Myers* case the Supreme Court emphasized that the unavailability of the injunction did not deprive litigants of any substantive rights, since claims of *res judicata* and lack of jurisdiction are always available as defenses.

"In other words, what the Supreme Court intended to do, and what it did in the *Myers* case and subsequent decisions, was precisely what seems to surprise the appellant; it most assuredly set up a different rule to govern the relationship between courts and administrative agencies from the traditional rule which (subject to the important limitation in Section 265

shown by our discussion of the *Myers* and *Oklahoma Press* cases later in this opinion, the doctrine of res judicata was not involved in either of those cases. As we understand them, those decisions hold that the progress of an administrative proceeding may not be interrupted by an injunction to enable a court to inquire into the agency's interlocutory determination of a statute's coverage. The quotation from the appellee's brief shown in the margin says:

> ". . . in the *Myers* case the Supreme Court emphasized that the unavailability of the injunction did not deprive litigants of any substantive rights, since claims of *res judicata* and lack of jurisdiction are always available as defenses."

We have been unable to find a statement of that tenor in the *Myers* opinion, nor have we discovered any reference in it to res judicata. Our conclusion, therefore, is that the Supreme Court has not held that a court cannot protect its decrees by enjoining the relitigation of the same issues between the same parties before an administrative agency.

No other reason has been suggested, and none is apparent to us, for holding that an administrative body which submits a legal question to a court of competent jurisdiction is not bound by its judgment. The rule is otherwise, as was held in *George H. Lee Company* v. *Federal Trade Commission*.[5] In that case the United States brought a libel proceeding in a district court to condemn 47 packages of "Gizzard Capsules," manufactured by George H. Lee Company. The government charged that the product was misbranded in that the labels and circulars contained false and fraudulent statements as to the properties of the product. The District Court held that

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of the Judicial Code) governs the relationship of courts among themselves."

Title 28, § 2283, U. S. C. A., which became effective September 1, 1948, is as follows:

> "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

The Revisor's note on § 2283 is to the effect that the words "where necessary in aid of its jurisdiction, or to protect or effectuate its judgments" were added to restore the basic law as generally understood and interpreted prior to the *Toucey* decision. So the "important exception" referred to in the foregoing quotation from the appellee's brief no longer exists.

[5] 113 F. (2d) 583 (C. C. A. 8th 1940).

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the challenged statements were not false. Thereafter the Federal Trade Commission issued its complaint charging George H. Lee Company with the use of unfair methods of competition in interstate commerce "by soliciting the sale of and selling 'Gizzard Capsules' upon 'extravagant, deceptive, misleading and false statements regarding the therapeutic value, efficacy and effect' of its product. . . ."

The Lee Company moved to strike so much of the complaint as was based upon representations as to the efficacy of its product on the ground that in the libel proceeding the falsity of such representations was an issue, and that the court in its decree had determined the product to be efficacious of the purpose for which it was manufactured and sold. The motion to strike was denied and the Lee Company then filed its answer denying the allegations of the complaint and asserting the defense of res judicata. The Commission overruled that defense, apparently upon the theory that the decree in the libel proceeding was not binding upon it; and proceeded, after hearing, to find the representations concerning the capsules to be false and fraudulent and entered a cease and desist order. The Company then appealed to the Court of Appeals for the Eighth Circuit. That court in the course of its opinion remarked (113 F. (2d) at 585):

> ". . . Although the remedies sought by the government in the two proceedings were different—condemnation in the first, and a cease and desist order in the second,—it is obvious that the alleged falsity of the representations of the petitioner with respect to the therapeutic value and effectiveness of its product constituted the main basis for each of the proceedings; . . . . It is equally obvious that the Commission completely disregarded the effect of the decree entered in the libel case *in conducting its proceedings* and in making its findings of fact, conclusions of law, and order." (Emphasis supplied.)

Toward the close of the opinion the court added (113 F. (2d) at 586):

> ". . . The Commission thus plainly failed to accord to the decree in the libel proceeding the effect to which it was entitled. The Commission redetermined an issue which was already settled by a court of competent jurisdiction and reached a contrary conclusion."

While it is true that the *Lee* case was an appeal after the Federal Trade Commission had completed its administrative hearing and had entered a final order, it is also true that the Court of Appeals regarded it as obvious that, *in conducting its proceedings* and in making its findings of fact, conclusions of law, and order, the Commission had completely disregarded the effect of the decree in the

libel case. That is to say, the court held that the Commission had no right to conduct the proceedings.

The reasoning of the *Lee* opinion seems to us to be sound, since it is plainly improper for an administrative body to conduct a proceeding for the purpose of relitigating with the same party a question of fact which has already been determined by a court of competent jurisdiction.

The Commission here contends that the District Court had no jurisdiction to entertain the present case and relies principally upon *Myers* v. *Bethlehem Shipbuilding Company*, 303 U. S. 41 (1938), and *Oklahoma Press Publishing Company* v. *Walling*, 327 U. S. 186 (1946).

In the *Myers* case the National Labor Relations Board initiated a proceeding before itself against the Bethlehem Shipbuilding Company charging it with unfair labor practices in interstate commerce. Notice was given of a hearing in which Bethlehem was required to participate. Before the hearing began, the Bethlehem Shipbuilding Company obtained in a United States district court an injunction forbidding the Board to proceed. The injunction was based on Bethlehem's allegation that it was not engaged in interstate commerce and that therefore the Board was without authority to proceed against it. The Supreme Court held that it was for the Board to decide in the first instance whether Bethlehem was engaged in commerce, that is to say, the determination of that question was a part of the administrative process and therefore the district court had no power to enjoin the hearing. It was held that the administrative process must proceed to a conclusion before any court could intervene and then the remedy lay in the appeal provided by the statute to a circuit court of appeals.

The *Oklahoma Press Publishing* case is to much the same effect. There the Wage and Hour Administrator, in an investigation under the Fair Labor Standards Act, ordered the Publishing Company to produce certain records. It declined to do so upon the ground that it was not subject to the Act. Thereupon, in a United States district court, the Administrator obtained an order compelling obedience to a subpoena and the action of the district court was affirmed by the circuit court of appeals and by the Supreme Court. The Publishing Company's contention was that the district court should have considered and determined the question whether the company was subject to the Fair Labor Standards Act before compelling obedience to the subpoena. As in the *Myers* case, the Supreme Court held that the coverage of the Act was a question for the Administrator in the first instance, and not for the district court; therefore the question of coverage, being a part of the administrative process, could not be reviewed except as provided by statute when the administrative proceeding had been completed.

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The *Myers* and *Oklahoma Press* cases are readily distinguishable from the present case. In neither of them was the doctrine of res judicata involved. In neither had there been a previous determination by a court of competent jurisdiction of the issue which the administrative agency was about to consider and decide. Those cases do not support the Commission's contention that an injunction may not be issued in the instant case because it would interrupt the hearing at the threshold, which may not be done under the principle that the administrative process must be completed before recourse can be had to a reviewing court. This is not the threshold of the administrative process, because the evidence has already been heard and the Commission has already announced its conclusion therefrom. The Commission's only possible purpose in desiring to reconsider the record, which has already been construed in one way by the Commission and later in the opposite way by the court, is to reverse the decision of the court.

In our opinion, the District Court was fully authorized in this case to enjoin the proceeding proposed by the Commission in order to protect its own jurisdiction and to prevent its previous judgment from being ignored. 28 U. S. C. A. § 1651.

The appellee further argues that the court's finding of a lack of prima facie evidence of fraud does not foreclose a subsequent administrative determination that the same evidence in fact shows fraud. The contention is based on the rule that an administrative finding of fact may not be disturbed upon judicial review if it is supported by substantial evidence; and on the theory that, although the record has been judicially held to lack prima facie evidence of fraud, nevertheless it may contain evidence which is "substantial" and therefore sufficient to insulate the Commission's finding of fraud from a reviewing court's scrutiny. In other words, the appellee asserts that "substantial evidence" under the rule of administrative finality may be less than prima facie evidence; and that the proof already gathered in its public investigation, though judicially branded as not a prima facie showing of fraud, may still be regarded by it as substantial enough to sustain a finding of fraud which may not be reviewed.

This is novel doctrine which, in our view, is dangerous in its application and implications. Prima facie evidence is a minimum quantity. It is that which is enough to raise a presumption of fact; or, again, it is that which is sufficient, when unrebutted, to establish the fact.[6] If an administrative finding is immune from judicial re-

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[6] *Cf.* the following statements concerning the nature of substantial evidence:

In *National Labor Relations Board* v. *Columbian Enameling & Stamping Co.*, 306 U. S. 292, 299, 300 (1939), substantial evidence

view when supported only by evidence which is insufficient even to raise a presumption that the fact exists, then the word "substantial" with respect to evidence means much less than we have heretofore supposed. To be substantial enough to support a nonreviewable finding of fact, evidence ought at least be enough to give rise to a presumption that the fact exists. Otherwise unbridled power to make irresponsible and unreviewable findings would be given to administrative agencies—a consummation we are unable to conceive of as a legislative purpose.

Evidence which is too weak, even when unrebutted, to establish the fact in question should never be considered substantial in the sense that an administrative finding based upon it is immune from judicial review. We reject the appellee's theory that the evidence accumulated during its public investigation may be substantial enough to support an unreviewable finding even though it has been judicially held not to amount to prima facie proof. To be substantial, evidence must be strong enough to raise a presumption of fact and must be sufficient, when undenied, to establish the fact. We conclude that "substantial evidence" under the rule of administrative finality does not mean something less than prima facie evidence. If this were not true, a commission such as the appellee could make an unreviewable finding of fact from a record so weak

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to support findings by administrative bodies is said to be that which affords

> ". . . a substantial basis of fact from which the fact in issue can be reasonably inferred. *Washington, V. & M. Coach Co.* v. *National Labor Relations Board*, 301 U. S. 142; *Consolidated Edison Co.* v. *National Labor Relations Board*, 305 U. S. 197; *Appalachian Electric Power Co.* v. *National Labor Relations Board*, 93 F. 2d 985, 989; *National Labor Relations Board* v. *Thompson Products Inc.*, 97 F. 2d 13; *Ballston-Stillwater Knitting Co.* v. *National Labor Relations Board*, 98 F. 2d 758, 764. Substantial evidence is more than a scintilla, and must do more than create a suspicion of the existence of the fact to be established. 'It means such relevant evidence, as a reasonable mind might accept as adequate to support a conclusion,' *Consolidated Edison Co.* v. *National Labor Relations Board, supra*, p. 229, and it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusions sought to be drawn from it is one of fact for the jury. See *Baltimore & Ohio R. Co.* v. *Groeger*, 266 U. S. 521, *Gunning* v. *Cooley*, 281 U. S. 90, 94; *Appalachian Electric Power Co.* v. *National Labor Relations Board, supra*, 989."
>
> ". . . substantial evidence is evidence furnishing a substantial basis of fact from which the fact in issue can reasonably be inferred; and the test is not satisfied by evidence which

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that it would not cause a reasonable mind even to presume the existence of the fact. This shocking proposition is condemned by its mere statement.

We have heretofore noted that the District Court decided, not whether fraud had been perpetrated, but whether the public investigation developed prima facie proof of fraud; and that the new administrative hearing will examine the same issue. But manifestly the trial judge inadvertently failed to notice that, under the pleadings, there would and could be no new evidence in the projected administrative proceeding. This is shown by the following excerpts from his opinion dismissing the complaint:

> "The Court considers that its decision in that proceeding [the subpoena enforcement proceeding], unless appealed from and reversed, is binding on the parties thereto. I do not think it can be said that that adjudication undertook to settle what would have been the situation had the record been different from that which the Court considered.
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> • • • • •
>
> "For me to speculate here on whether or not there is going to be a different record, or whether they are going to depend upon the same kind of evidence that was submitted in the subpoena enforcement proceedings, is perfectly futile."

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merely creates a suspicion or which amounts to no more than a scintilla or which gives equal support to inconsistent inferences." *Appalachian Electric Power Co.* v. *National Labor Relations Board*, 93 F. (2d) 985, 989 (C. C. A. 4th 1938).

" 'Substantial evidence' means more than a mere scintilla. It is of substantial and relevant consequence and excludes vague, uncertain, or irrelevant matter. It implies a quality of proof which induces conviction and makes an impression on reason. It means that the one weighing the evidence takes into consideration all the facts presented to him and all reasonable inferences, deductions and conclusions to be drawn therefrom and, considering them in their entirety and relation to each other, arrives at a fixed conviction.

"The rule of substantial evidence is one of fundamental importance and is the dividing line between law and arbitrary power. Testimony is the raw material out of which we construct truth and, unless all of it is weighed in its totality, errors will result and great injustices be wrought." *National Labor Relations Board* v. *Thompson Products, Inc.*, 97 F. (2d) 13, 15 (C. C. A. 6th 1938).

See also United States v. *United States Gypsum Co.*, 67 F. Supp. 397, 451 (D. C. D. C. 1946), reversed on other grounds.

Of course, the trial court was not called upon to speculate whether there would be a different record, because by its motion to dismiss the appellee admitted that the record would be the same.

The order dismissing the complaint will be set aside and the cause will be remanded. The appellee will then have an opportunity to answer and to deny the allegation that no additional evidence concerning Eaton's collusion will be introduced at its new hearing, and so be relieved of the bar of res judicata. If it does not make such a denial, an injunction will be issued in accordance with the prayer of the complaint, in which event the Commission may nevertheless proceed with the hearing, if it desires, upon the same evidence received in its public investigation, to consider suspending or expelling Otis from the National Association of Securities Dealers, Inc., on a ground other than the alleged instigation of the Masterson suit.

Reversed and remanded.

United States Court of Appeals for the District of Columbia Circuit—Filed Jun. 1, 1949. Joseph W. Stewart, Clerk.

United States Court of Appeals for the District of Columbia Circuit
April Term, 1949

No. 10058

OTIS & COMPANY, APPELLANT

vs.

SECURITIES & EXCHANGE COMMISSION, ET AL., APPELLEES

Appeal from the United States District Court for the District of Columbia

Before STEPHENS, C. J., and WILBUR K. MILLER and PROCTOR, JJ.

Judgment

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Columbia, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the order of the said District Court appealed from in this cause be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

Per Circuit Judge WILBUR K. MILLER.

Dated June 1, 1949.

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United States Court of Appeals for the District of Columbia Circuit—Filed Jun. 13, 1949. Joseph W. Stewart, Clerk.

In the United States Court of Appeals for the District of Columbia Circuit

No. 10058

OTIS & COMPANY, APPELLANT

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL., APPELLEES

Motion for Stay of Mandate

The appellees respectfully move this Honorable Court, in accordance with Rule 27 of the Rules of this Court, to stay the mandate pursuant to the Court's opinion herein of June 1, 1949, pending application to the Supreme Court for a writ of certiorari. The filing of a petition for a writ of certiorari on behalf of the appellees has been authorized by the Solicitor General.

Since it is unlikely that the petition can be prepared, cleared with the Solicitor General and printed within the thirty-day period referred to in Rule 27(c), the appellees respectfully move that the stay extend for the entire ninety days permitted for the filing of a petition for certiorari by the Judicial Code (28 U. S. C. § 2101 (a) as amended). The appellant should not be prejudiced by such a stay in view of the fact that the petition for certiorari cannot be decided in any event by the Supreme Court until it reconvenes in the fall. The appellees plan, of course, to file their petition in the Supreme Court as soon as possible.

LOUIS LOSS,
Associate General Counsel,
Securities and Exchange Commission,
425 Second St., N. W.,
Washington 25, D. C.

June 13, 1949.

Certificate of Service

I, Louis Loss, certify that service of this motion was made today, June 13, 1949, by mailing copies thereof in penalty envelopes, addressed to Thurman Arnold, Esquire and Joseph L. Weiner, Esquire, counsel for the appellant.

LOUIS LOSS.

United States Court of Appeals for the District of Columbia Circuit—Filed Jul. 21, 1949. Joseph W. Stewart, Clerk.

United States Court of Appeals for the District of Columbia Circuit, April Term, 1949

No. 10058

OTIS & COMPANY, APPELLANT

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL., APPELLEES

Before STEPHENS, C. J., and WILBUR K. MILLER and PROCTOR, JJ.

Order

On consideration of appellee's motion to stay the mandate herein, for ninety days pending filing of petition for writ of certiorari in the Supreme Court in this cause, and of appellant's objections thereto, It is

Ordered by the court that the mandate in this case be, and it is hereby, stayed to and including July 30, 1949.

Per Curiam.

Dated July 21, 1949.

United States Court of Appeals for the District of Columbia Circuit—Filed Jul. 29, 1949. Joseph W. Stewart, Clerk.

In the United States Court of Appeals for the District of Columbia Circuit

No. 10058

OTIS & COMPANY, APPELLANT

vs.

SECURITIES AND EXCHANGE COMMISSION, ET AL., APPELLEES

Designation of Record

The Clerk will please prepare a certified transcript of record for use on petition to the Supreme Court of the United States for a writ of certiorari in the above-entitled cause, and include therein the following:

1. Joint Appendix.
2. Statement of Points on Appeal (Page 14 of appellant's brief).
3. Motion for a Stay.

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4. Order for Injunction.
5. Opinion.
6. Judgment.
7. Motion of Securities and Exchange Commission for Stay of Mandate.
8. Order Staying Mandate.
9. This Designation.
10. Clerk's Certificate.

PHILIP B. PERLMAN,
Solicitor General,
Counsel for Appellees.

Certificate of Service

I hereby certify that I have this day served a copy of the Designation of Record on the following parties by mailing copies to them at their business addresses: Joseph L. Weiner, 52 Wall Street, New York, 23, New York; Milton V. Freeman, Abe Fortas, Thurman Arnold, 1200 18th Street, N. W., Ring Building, Washington 6, D. C.

PHILIP B. PERLMAN,
Solicitor General.

July 29, 1949.

United States Court of Appeals for the District of Columbia Circuit

I, Joseph W. Stewart, Clerk of the United States Court of Appeals for the District of Columbia Circuit, hereby certify that the foregoing pages, numbered 1 to 91, both inclusive, constitute a true copy of the joint appendix to the briefs of the parties and the proceedings of the said Court of Appeals, as designated by counsel in the case of: Otis & Company, Appellant, v. Securities and Exchange Commission, Edmund M. Hanrahan, Robert K. McConnaughey, Richard B. McEntire, Harry A. McDonald and Paul R. Rowen, Appellees, No. 10,058, April Term, 1949, as the same remain upon the files and records of said Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of said Court of Appeals, at the city of Washington, this fourth day of August, A. D. 1949.

[SEAL.]

JOSEPH W. STEWART,
Clerk of the United States Court of Appeals for the District of Columbia Circuit.

In the Supreme Court of the United States, October Term, 1949

No. —

SECURITIES AND EXCHANGE COMMISSION, ET AL., PETITIONER

vs.

OTIS & COMPANY

Stipulation

Subject to this court's approval, it is hereby stipulated and agreed, by and between counsel for the respective parties hereto, that for the purpose of the petition for writ of certiorari the printed record may consist of the following:

1. Joint Appendix.
2. Statement of Points on Appeal.
3. Motion for a Stay.
4. Order for Injunction.
5. Opinion.
6. Judgment.
7. Motion of Securities and Exchange Commission for Stay of Mandate.
8. Order Staying Mandate.
9. Clerk's Certificate.

It is further stipulated and agreed that petitioner will cause the Clerk of the United States Court of Appeals for the District of Columbia Circuit to certify and file with the Clerk of the Supreme Court of the United States the entire transcript of record on appeal in the United States Court of Appeals for the District of Columbia Circuit; and that in the event the petition for writ of certiorari is granted, the printed record shall consist of the proceedings in the court below and such portions of the complete transcript of record on appeal in that court as the parties may designate.

It is further stipulated and agreed that either of the parties hereto may refer in his brief to the record filed in the Supreme Court of the United States, including any part thereof which has not been printed.

PHILIP B. PERLMAN,
Solicitor General,
Counsel for Petitioner.
THURMAN ARNOLD,
Counsel for Respondent.

August 4, 1949.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1949 948627 87

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 244

SECURITIES AND EXCHANGE COMMISSION, EDMOND M. HANRAHAN, RICHARD B. MCENTIRE, HARRY A. MCDONALD, AND PAUL R. ROWEN, PETITIONERS

v.

OTIS & CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Securities and Exchange Commission and its members, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered on June 1, 1949, which reversed the judgment entered on November 12, 1948, by the United States District Court for the District of Columbia.

OPINIONS BELOW

The opinion of the Court of Appeals (R. 72-86) has not yet been officially reported. The oral

opinion of the District Court (R. 65-67) has not been officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on June 1, 1949 (R. 86). The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254 (formerly Sections 239 and 240 of the Judicial Code), made applicable by Section 25(a) of the Securities Exchange Act of 1934, 48 Stat. 901, 15 U.S.C. § 78y (a).

QUESTIONS PRESENTED

1. Whether, notwithstanding the doctrine of *Myers* v. *Bethlehem Shipbuilding Corporation,* 303 U. S. 41, a district court has jurisdiction to enjoin the consideration of certain issues in an administrative proceeding unless the agency controverts an allegation that no "new evidence" will be presented in that proceeding beyond that which was considered by the district court in an unsuccessful subpoena-enforcement action brought in aid of an earlier administrative investigation.

2. Whether a holding, in a judicial proceeding for the enforcement of an administrative subpoena, as to the non-existence of a *prima facie* case of fraud sufficient to pierce a claim of attorney-client privilege is *"res judicata"* on the issue of fraud in a subsequent adversary administrative proceeding, in the absence of "new evidence."

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STATUTE INVOLVED

The pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. § 78a *et seq.* (hereinafter referred to as "the Act"), are set forth in the Appendix, *infra*, at pages 21-24.

STATEMENT

The controversy had its genesis in an underwriting contract entered into on February 3, 1948, whereby Otis & Co. and two other firms undertook to purchase from Kaiser-Frazer Corporation a large block of its common stock with a view to effecting a public distribution. It was one condition of the contract that there should be no material litigation pending against Kaiser-Frazer Corporation as of 10:00 a.m. on February 9, which was the settlement date under the contract. The public offering was unsuccessful and was withdrawn by the underwriters. Shortly before 10:00 a.m. on February 9, one Masterson instituted a lawsuit against Kaiser-Frazer Corporation and others in Detroit. On the basis, at least in part, of that suit, Otis & Co. refused to perform its contract. (R. 3-4, 12-13, 23-26.)

On February 18, 1948, the Commission instituted a private investigation to determine, among other things, whether certain anti-fraud provisions of the Securities Exchange Act of 1934 had been violated as a result of the circumstances under which the Masterson suit had been filed (R. 11-14). On the basis of information reported to the Commission by the officers who had conducted that

investigation, the Commission on March 23, 1948, ordered a public investigation (R. 15-17).[1]

During the course of the public investigation, evidence was adduced which, in the Commission's opinion, indicated *prima facie* that the Masterson suit had been inspired by Otis & Co. or by Cyrus S. Eaton, its controlling stockholder (R. 18-21, 23-26). It appeared, among other things, that two Cleveland attorneys, named Harrison and Hull, had made inquiries about that suit at the court house in Detroit prior to its filing on the morning of February 9. As a result of a subpoena-enforcement action in the United States District Court for the Eastern District of Michigan they admitted that the client who had retained them in connection with the suit was Eaton. After the investigation had produced further evidence linking Eaton to the Masterson suit, Harrison and Hull were recalled to appear in Washington and testify concerning their communications with Eaton. They appeared but declined to answer on the ground of attorney-client privilege. Thereupon the presiding officer, upon instructions from the Commis-

[1] The stated purpose of this public investigation included an inquiry not only into the question of misconduct by Otis & Co., but also into the question whether the Commission should prescribe rules and regulations under the Securities Exchange Act or recommend further legislation to the Congress pursuant to Section 21(a) of that Act, 48 Stat. 899, 15 U.S.C. § 78u(a). A counterclaim by Otis & Co. seeking an injunction against further investigation was dismissed by the United States District Court for the District of Columbia in *S.E.C.* v. *Harrison*, 80 F. Supp. 226, discussed *infra*, pp. 5-6. This decision was not appealed and the time for appeal has expired.

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sion, ruled that the privilege was unavailable because the evidence indicated *prima facie* that the communications were for a fraudulent or improper purpose and hence within a well-recognized exception to the privilege. *Clark* v. *United States,* 289 U. S. 1, 15.

Upon the continued refusal of Harrison and Hull to testify, the Commission, on June 25, 1948, filed a second action to compel their testimony under Section 21(c) of the Act, 48 Stat. 899, 15 U.S.C. § 78u(c), this time in the United States District Court for the District of Columbia (R. 18-22). Otis & Co. and Eaton were permitted to intervene in this proceeding. To support the claim of *prima facie* fraud in the institution of the Masterson suit, the Commission, after objection by the defendants and interveners to the use of affidavits, offered the entire record of its public investigation to that date. It was an *ex parte* record of some 5,000 pages made without cross-examination or the right to call witnesses in the orthodox sense (R. 35-37.) The defendants and interveners, by counterclaim, sought to enjoin the Commission's investigation (R. 36-37).

The District Court, relying in part on the absence of cross-examination in the administrative record, held that under the circumstances "the requisite *prima facie* showing of fraud to pierce the attorney-client privilege and relieve the communications here sought to be disclosed from immunity has not been made" (R. 43). Judge Morris emphasized

(R. 44): "The Court, in these proceedings, is not required, nor would it be proper, to make findings as to whether or not the fraud charged was perpetrated, but only to determine whether or not the evidence in the record, without more, constitutes a *prima facie* showing of such fraud." He also made it clear that his decision did not preclude any further inquiries directed even to the same attorneys with respect to anything "other than communications between the intervenor and his attorneys" (R. 44). At the same time he dismissed the counterclaim for an injunction against further investigation of the Masterson suit (R. 45). *S.E.C.* v. *Harrison,* 80 F. Supp. 226.

The case was argued in the District Court on July 19, 20 and 21, and decided on October 18, 1948. On August 11, while the matter was still pending, the Commission had instituted an adversary administrative proceeding against Otis & Co. under Sections 15(b) and 15A(l)(2) of the Act, 49 Stat. 1377, 52 Stat. 1070, 15 U.S.C. §§ 78o(b), 78o-3(l)(2), to determine whether it had violated certain of the anti-fraud and other provisions of the securities statutes and, if so, whether its registration as a broker and dealer should be revoked or whether it should be suspended or expelled from the National Association of Securities Dealers (R. 23-29). Over the objections of the Commission, Otis & Co. and Eaton obtained successive stays from other judges against the holding of hearings in this proceeding pending Judge Morris' decision. After Judge Mor-

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ris had refused to enforce the subpoena and denied the injunction sought by the counterclaim, and the stays had expired, the Commission ordered the administrative hearing on the merits of the case to commence on November 15, 1948 (R. 47-48). This put the Commission in a position to cure the alleged defect of absence of cross-examination, and at the same time to weigh the evidence adduced in the administrative proceeding with a view to reaching a final determination one way or the other, or perhaps reapplying to the court on the basis of the new record if circumstances appeared to warrant such action.[2]

At that point Otis & Co. instituted an independent action in the District Court in which it prayed that the Commission and its members be enjoined from considering in the administrative proceeding the question of the instigation of the Masterson suit and the termination of the underwriting contract (R. 2-10). The complaint sought an injunction against "taking any evidence, compelling attend-

[2] This method of procedure, it was optimistically thought, would avoid the delay attendant upon an appeal. Not one but two appeals might well have been required. The Court of Appeals might have agreed with the Commission that the district judge had applied too strict a standard of proof—in the opinion here sought to be reviewed it did refer to *prima facie* evidence as a "minimum quantity" (R. 83)—and might have remanded for a determination of the question of *prima facie* evidence of fraud under the proper standard. Then, whatever the determination of the District Court on remand, there would probably have been a second appeal. Also, there might thus have been two petitions to this Court for writs of certiorari. All this would have preceded any approach to the merits of the ultimate question of fraud by the only tribunal with jurisdiction to decide that question—the Commission.

unto all hearings, or taking any action whatsoever, with respect to the above matters" (R. 10). The theory of the complaint was that the earlier decision of the District Court had rendered *res judicata* the question whether the Masterson suit had been inspired by Otis & Co. or Eaton (R. 8-9). Judge Morris dismissed the complaint from the bench on the grounds (1) that he had never undertaken to decide the ultimate question of fraud *vel non* in the subpoena action, and (2) that the doctrine of *Myers v. Bethlehem Shipbuilding Corporation*, 303 U. S. 41, required the plaintiff to exhaust its administrative remedy before obtaining judicial review, which could be done in the proper court of appeals pursuant to the statute if the Commission's final order was adverse (R. 65-67).

The plaintiff appealed to the court below and obtained from that court, over the objection of the Commission, an order staying the administrative hearing, in so far as it related to the Masterson suit, pending the appeal (R. 71).[1] The case was argued below on December 17, 1948, and decided on June 1, 1949.

The court below reversed the judgment of the District Court (R. 72-86). The court observed that

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[1] Although the Commission has never been enjoined from conducting its proceeding insofar as the issues therein do not concern the Masterson suit, it has deemed the holding of a hearing on the remaining issues impracticable because the facts involved in the various issues are intertwined; accordingly the Commission has not attempted to proceed pending the determination of this controversy in the courts.

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the complaint in the action for injunction had alleged, on "information and belief," that the Commission "does not have and cannot produce any evidence in addition to that in the record of its so-called public investigation" (R. 75). This allegation, said the court, was admitted by the Commission's motion to dismiss the complaint. Thus the court found an identity of issues making operable the doctrine of *res judicata*. The District Court's prior finding as to absence of probable cause in the subpoena proceeding was held to be decisive as to the merits of the charge of fraud to be heard by the Commission. *Myers* v. *Bethlehem Shipbuilding Corporation* was held to be inapplicable. The court remanded the cause to give the Commission "an opportunity to answer and to deny the allegation that no additional evidence concerning Eaton's collusion will be introduced at its new hearing, and so be relieved of the bar of *res judicata*" (R. 86). The court subsequently stayed its mandate pending the determination of this application for a writ of certiorari.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that a determination of probable cause in a subpoena-enforcement proceeding is *res judicata* as to the ultimate issue which the statute provides shall be decided on the merits by the administrative agency, subject to a limited review by a court of appeals.

2. In holding the issue in a subpoena-enforcement proceeding to be the same as the issue to be decided by the Commission on the merits for purposes of *res judicata.*

3. If it be assumed that the doctrine of *res judicata* is applicable, in enjoining the administrative proceeding rather than allowing the defense of *res judicata* to be raised in due course during the administrative and judicial proceedings prescribed by the statute.

REASONS FOR GRANTING THE WRIT

1. The holding below that *res judicata* creates an exception to the doctrine of primary jurisdiction and the rule against enjoining administrative hearings raises a novel and important question upon which this Court should pass.

The Securities Exchange Act vests in the Commission primary jurisdiction to determine whether the registration of a broker or dealer should be revoked for fraud or whether he should be suspended or expelled from membership in a "national securities association," subject to review only by a court of appeals in the manner specified in the statute.[4] In order to effectuate its primary jurisdiction, the Commission is empowered to seek the aid of a dis-

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[4] The jurisdictional sections are 15(b), 15A(l)(2), 25, 49 Stat. 1377, 52 Stat. 1070, 48 Stat. 901, 15 U.S.C. §§ 78o(b), 78o-3(l)(2), 78y. The fraud sections are 10(b), 15(c)(1), 48 Stat. 891, 52 Stat. 1075, 15 U.S.C. §§ 78j(b), 78o(c)(1), together with specified rules thereunder, and Securities Act of 1933, § 17(a), 48 Stat. 84, 15 U.S.C. § 77q(a).

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trict court to enforce its subpoenas. The decision below invokes a novel sort of *res judicata* doctrine —one which may be avoided by adducing "new evidence"—to make the preliminary determination by the district court in connection with the issuance of a subpoena binding upon the Commission as to the merits of the case unless the district court is first satisfied that the agency has new evidence. This result is in conflict with the statutory scheme whereby the merits of the controversy are first to be submitted to the specialized body established to deal with such problems, and then to a court of appeals (not a district court) to determine whether the administrative decision has a rational basis in fact and in law.

The decision below thus is inconsistent with the doctrines as to primary jurisdiction and the exhaustion of administrative remedies and the oft-repeated rule that administrative hearings cannot be enjoined. *Myers* v. *Bethlehem Shipbuilding Corp.*, 303 U. S. 41; *Newport News Shipbuilding and Dry Dock Co.* v. *Schauffler*, 303 U. S. 54; *Macauley* v. *Waterman Steamship Corp.*, 327 U. S. 540, 545; *Federal Power Commission* v. *Arkansas Power & Light Co.*, 330 U. S. 802; *Aircraft & Diesel Equipment Corp.* v. *Hirsch*, 331 U. S. 752, 775-81. The fact that the agency may be forced by the recalcitrance of a witness to look to a district court to compel testimony is not adequate basis for transferring the agency's primary jurisdiction to

the district court, or for enjoining the administrative hearing.

It is settled that resort must first be had to the administrative process, even as against an allegation that the administrative body lacks statutory or even constitutional jurisdiction. See cases cited *supra*. The doctrine of *res judicata* is not jurisdictional,[5] and an allegation of *res judicata* certainly has no greater stature than an alleged absence of constitutional or statutory authority. If statutory requirements as to the procedure to be followed must be observed even when the defense is that the statute is inapplicable to the subject matter, the same would seem to be more clearly true with respect to the defense of *res judicata*, a doctrine which lacks the force of an explicit statutory provision.

The decision below appears to turn upon the significance attached to the Commission's "admission" of the allegation that it has no "new evidence" by filing a motion to dismiss. But the fact that allegations which would establish a defense on the merits are admitted for purposes of a motion to dismiss does not justify departure from the rule requiring exhaustion of administrative remedies. The court below made the same error in *Waterman*

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[5] *Philadelphia, Wilmington and Baltimore R. R. Co.* v. *Howard*, 13 How. 307, 334; *United States* v. *Bliss*, 172 U. S. 321, 326; *Mercoid Corporation* v. *Mid-Continent Investment Co.*, 320 U. S. 661, 670; *Murrell v. Stock Growers' Nat. Bank of Cheyenne*, 74 F. 2d 827, 832-33 (C.A. 10) and cases cited therein.

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Steamship Corporation v. *Land,* 80 App. D. C. 167, 151 F. 2d 292, reversed *sub nom. Macauley* v. *Waterman Steamship Corporation,* 327 U. S. 540, where it said (151 F. 2d at 294-295):

> And if it is a fact, as the complaint alleges—*and as the motion to dismiss admits*—that the contracts (charter parties) in issue were contracts with the British Government, it follows, of course, that the Commission, in undertaking to investigate profits, is exceeding its statutory powers. [Italics are the court's.]

This Court reversed on the ground that the District Court "lacked jurisdiction to act" (327 U. S. at 545).

As in the *Waterman* case, the court below has again held that an administrative hearing may be displaced in favor of a preliminary judicial inquiry by reason of a pleader's bare allegation of a fact which if true would prove, in the opinion of the court below, that the administrative inquiry would be a fruitless and harassing undertaking. As stated by Justice Arnold in his dissenting opinion in the *Waterman* case (151 F. 2d at 300), "It is naive to think that this device will not be used for purposes of delay."

The type of trial which would be required in this case by the decision below emphasizes the wisdom of not creating an exception to the primary jurisdiction rule. The question at issue would be not whether Otis & Co. had been guilty of fraud, but whether the Commission, if it ultimately were al-

lowed to come to the question of fraud in its administrative proceeding, would be able to make a stronger case than it had made in the *ex parte* investigation. The respondent presumably could prove its allegations that the Commission lacked any new evidence only by taking the testimony of the members of the Commission and Commission attorneys. The District Court would then doubtless be called upon to rule on the substantiality and materiality of any such evidence, a duty which the statute imposes upon the Commission itself. Any District Court decision could be taken to the Court of Appeals and perhaps to this Court, all before the Commission would have an opportunity to hold its hearing on the merits of the case in the manner prescribed by the statute. The possibility of further long delays of proceedings which have already been stayed for almost a year are manifest. This Court has emphasized that, "To be effective, judicial administration should not be leaden-footed," *Cobbledick* v. *United States*, 309 U. S. 323, 325; and this is no less true of law enforcement by administrative agencies and the courts jointly.

The Commission did not argue, as the court below apparently suggests (R. 79-80), that the doctrine of *res judicata* is not applicable to administrative agencies, though when and under what circumstances it is applicable are exceedingly complex questions toward the solution of which the courts are still finding their way. See Davis, *Res Judicata in Administrative Law*, 25 Tex. L. Rev.

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199; Note, *Res Judicata and Intra-Governmental Inconsistencies,* 49 Col. L. Rev. 640. We do maintain, however, that the Congress vested in the Commission the primary fact-finding function as an expert administrative body, and that, when the Congress at the same time gave the Commission no alternative against a recalcitrant witness but to look to the courts to enforce its subpoenas, the Congress could not have intended that the price of failure to obtain court aid should be a surrender of the agency's fact-finding function.[6]

The effect of the decision is to subject an administrative agency to the risk of a one-way surrender of its own ultimate fact-finding jurisdiction to the district court when it seeks to enforce an administrative subpoena against a recalcitrant witness. Although there can be no final determination of the ultimate issues in the agency's favor if the agency *wins* the subpoena proceeding, it is forever barred from exercising its own fact-finding functions if it loses the subpoena proceeding unless it first controverts in the district court an allegation that it has no "new evidence."

These considerations demonstrate that the doc-

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[6] This case need not be complicated by abstract consideration of the question whether "substantial evidence" constitutes more or less than a "*prima facie* case," a matter much discussed by the court below (R. 83-85). While the Securities Exchange Act, like most other statutes, is silent on the subject of what constitutes substantial evidence, the Commission does not doubt that its findings of fact should always be sustained by what is, in its view, a fair preponderance of the evidence. The substantial evidence rule is simply a measure of judicial forbearance in the face of attack on agency findings.

trine of *res judicata* cannot be availed of so as to cause a ruling in an ancillary proceeding to frustrate the statutory grant of primary jurisdiction to an administrative body. They also show that the defense can be raised, if at all, only before the administrative body itself and a statutory court of review, and not in a suit to enjoin use of the statutory procedure.[7]

2. The issue which was before the District Court in the subpoena action and the issue in the pending administrative proceeding are not the same. Many cases establish that determinations in preliminary or ancillary proceedings in which the question is one of probable cause are not *res judicata* when the ultimate issue comes before the courts on the merits.[8] These close analogies prove

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[7] If the Commission is permitted to hold its administrative hearing, the arguments of Otis & Co. concerning *res judicata*, and any related arguments based on the significance of the District Court's ruling in the subpoena case, will have a concrete setting in the context of an actual, not a hypothetical, administrative record. It will then be possible to *know* whether the evidence before the Commission differs substantially from that before the Court in the subpoena proceeding, if that is material. It is impossible now to forecast the significance of according Otis & Co. the rights of a party, including the right of cross-examination, in the absence of which the District Court held that the evidence relied on to show a *prima facie* case of fraud must be "subjected to the strictest scrutiny for possible ambiguity and equivocation" (R. 43). Nor is it possible to forecast whether the witnesses' testimony at such a hearing will vary from their testimony upon the preliminary investigation, or to determine the significance of any variance that may occur.

[8] Re-arrest and trial after discharge upon a preliminary examination: *Ex parte Crawlin*, 92 Ala. 101, 9 So. 334; *Ex parte Fenton*, 77 Cal. 183, 19 Pac. 267; *In re Garst*, 10 Neb. 78, 81, 4 N.W. 511; *Ex parte Oxley*, 38 Nev. 379, 383, 149 Pac.

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that the issue of probable cause is not regarded as the same issue as that on the merits of the proceeding, or, what is equally decisive here, that *res judicata* may not be invoked in such situations.

3. The detrimental effect of the decision below upon the general fact-finding functions of administrative agencies is by no means limited to instances where an agency attempts to pierce a claim of attorney-client privilege by showing *prima facie* fraud. Factual exploration by such agencies, whether in the course of investigations or in the course of adversary proceedings, is dependent in the long run upon the aid of the courts, for it is to the courts that they must resort for enforcement of their subpoenas. The number and scope of the issues that may arise in such proceedings are limitless. Thus, a witness may refuse to testify on a certain subject on the ground of immateriality. The question of materiality may in turn hinge upon the probable truth of propositions A, B and C, which may be central issues in the

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992, 993; cf. *United States* ex rel. *Rutz* v. *Levy*, 268 U. S. 390, 393.

Removal proceedings after discharge for lack of probable cause in an earlier removal proceeding: *United States* ex rel. *Rutz* v. *Levy*, 268 U. S. 390; *United States ex rel. Povlin* v. *Hecht*, 48 F. 2d 90, 91 (C.A. 2).

Re-indictment after quashing of earlier indictment for failure to present *prima facie* case to grand jury: *People* v. *Roth*, 128 Misc. 550, 220 N.Y.S. 167; *People* v. *Horvatt*, 237 App. Div. 289, 261 N.Y.S. 303, affirmed *sub nom. People* v. *Mangan*, 262 N.Y. 508, 188 N.E. 41; *Hill* v. *State*, 20 Ala. App. 197, 101 So. 298; cf. *Brady* v. *United States*, 24 F. 2d 397, 405 (C.A. 8), certiorari denied, 278 U. S. 603.

administrative proceeding or wholly collateral to it. If the agency involved cannot convince the enforcement court of the probable truth of propositions A, B and C, it may not obtain an order compelling the testimony of the recalcitrant witness. But, under the decision below, propositions A, B and C are in effect carved out of the issues involved in the agency proceeding, for the agency is bound by what the court determines in the proceeding to enforce the subpoena. And those propositions become the subject of district court determination (subject to appeal) before they may be acted upon by the agency and subsequently by the statutory appellate court sitting in review of final agency action. Thus, the subpoena-enforcement proceeding intended by the Congress as an aid to administrative fact-finding becomes a trap in which the agency proceeding is disrupted and delayed.

The decision below also weakens the important rule permitting the attorney-client privilege to be pierced upon a showing of *prima facie* fraud in the relationship. *Clark* v. *United States,* 289 U.S. 1, 15. Any person attempting to obtain evidence by piercing the claim of privilege will pause before taking the risk that an adverse ruling as to the privilege may be *res judicata* as to his case on the merits.

The decision below applies, moreover, with equal logic and with equally bad consequences to judicial discovery proceedings, which have been said by this Court to be "essentially the same" as admin-

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istrative fact-finding and to be "governed by the same limitations." *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 216. If, during the course of a judicial proceeding in jurisdiction A, the court is not satisfied that probable cause has been shown to compel certain testimony, that is not a bar to a later attempt to prove the basic issue in the case. However, if ancillary discovery proceedings are conducted in jurisdiction B, then any issue decided in the discovery proceedings, however tentatively, and whether for the one side or the other, is binding for all purposes in jurisdiction A; and the trial in the first court must be suspended while efforts are made to change the mind of the second court with "new evidence." We have been unable to find any precedent for such a procedure.

4. The petitioners should not be required to answer and let the case be tried in the District Court instead of by the Commission before obtaining review of the holding of the court below. The decision below is so patently inconsistent with the basic doctrine of the *Myers* case that it should be reviewed now without permitting further delay. In the many *Myers*-type cases before this Court a writ of certiorari has typically been granted without requiring the agency to answer and stand trial in the district court.[9]

[9] While the petitioners have not yet answered the allegation that there is no "new evidence," and while they do not mean to imply that they will admit that allegation, it may be inferred from the history of this proceeding that the peti-

5. What has been said is apart from the importance of this case itself in the administration of the securities laws. The process of raising capital by the flotation of securities is geared in large part to the good faith of investment bankers when they give the issuing corporation a firm commitment. When there are suspicious circumstances in connection with the disavowal of such a commitment, there is great public concern. A proceeding before the expert administrative body looking toward a final determination of the question whether there has been a violation of the securities statutes in such a case should not be aborted by the novel application of doctrine which was never meant to frustrate the functioning of the administrative process in the manner prescribed by Congress.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ROGER S. FOSTER,
General Counsel,
Securities and Exchange Commission.

AUGUST, 1949.

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tioners know of no startling piece of "new evidence" whose production in the District Court would result in a final judgment for them under the decision below and hence render academic the questions raised by this petition.

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APPENDIX

The pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U. S. C. § 78a *et seq.* are as follows:

SEC. 15. (a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section.

(b) * * * * *

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, * * * (D) has willfully violated any provision of the Securities Act of 1933, as amended, or of this title, or of any rule or regulation thereunder. * * *

SEC. 15A. (l) The Commission is authorized, if such action appears to it to be necessary or

appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

* * * * *

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof who the Commission finds (A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder, or (B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule or regulation; * * *.

* * * * *

SEC. 21. (a) The Commission may, in its discretion, make such investigation as it deems necessary to determine whether any person has violated or is about to violate any provision of this title or any rule or regulation thereunder, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning

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the matter to be investigated. The Commission is authorized, in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of the provisions of this title, in the prescribing of rules and regulations thereunder, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates.

(b) For the purpose of any such investigation, or any other proceeding under this title, any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

(c) In case of contumacy by, or refusal to obey a subpena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring

such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. * * *

* * * * *

SEC. 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the United States Circuit Court of Appeals for the United States, within any circuit wherein such person resides or has his principal place of business, or in the Court of Appeals of the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court

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for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 244.

SECURITIES AND EXCHANGE COMMISSION, EDMOND M. HANRAHAN, RICHARD B. MCENTIRE, HARRY A. MCDONALD, and PAUL R. ROWEN, *Petitioners*,

v.

OTIS & CO., *Respondent*.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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September, 1949.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 244.

SECURITIES AND EXCHANGE COMMISSION, EDMOND M. HANRAHAN, RICHARD B. MCENTIRE, HARRY A. MCDONALD, and PAUL R. ROWEN, *Petitioners,*

v.

OTIS & CO., *Respondent.*

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI*

Otis & Co., respondent herein, respectfully submits that the petition for a writ of certiorari should be denied for the reasons set forth below.

COUNTER STATEMENT OF FACTS

The facts are set forth in the complaint (R. 2-10) and in affidavits in support of a motion for injunction (R. 49-65).

Respondent is an investment banking house with its main offices in Cleveland, Ohio (R. 2). It was one of the underwriters of a proposed issue of stock of Kaiser-Frazer Cor-

* Page references (R. —) are to the Joint Appendix. Emphasis is supplied except as otherwise indicated.

poration. On February 9, 1948, the settlement date specified in the underwriting agreement, Otis terminated its obligations thereunder for a number of reasons. (R. 4). Among the latter was non-compliance with a requirement that no material litigation be pending against Kaiser-Frazer. Such non-compliance was due to a stockholder's derivative suit filed by one Masterson shortly before the time fixed for settlement (R. 4).

Within a few days Kaiser-Frazer filed suit against Otis in New York charging breach of the underwriting agreement. (R. 4, 54). One of the allegations in that case is that Otis, acting through Eaton, one of its principal stockholders, caused Masterson to file his suit in order to provide a basis for Otis' termination of the agreement. (R. 4).

Although that issue would presumably be determined in that action, the SEC commenced an investigation of the charge on the ground that it might involve violation of the securities laws. (R. 5, 11-14). The ordinary conclusion of such an investigation is either a closing of the file, or the institution of formal proceedings if probable violation has been found (R. 5). The Commission did neither. Instead, it issued an "Order for Public Investigation" of the same matters (R. 5, 15-17). Hearings were held in eight cities, ranging from New York to California, and a record was made consisting of some 5000 pages of testimony and hundreds of exhibits (R. 37, 56). Otis was not permitted to cross-examine witnesses nor to introduce testimony (R. 5, 62, 63).

At the apparent conclusion of the "public investigation" the Commission ordered a further hearing in Washington and recalled two of the witnesses, Harrison and Hull, who had previously testified that they were attorneys for Eaton. They were questioned concerning their conversations with their client, which they refused to disclose on the ground of attorney-client privilege. The presiding officer then announced that the Commission had instructed him to direct

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the witnesses to answer these questions because the Commission found that the evidence in the record established *prima facie* that the attorneys had participated with Eaton in the accomplishment of a fraudulent purpose, namely, the instigation of the Masterson suit (R. 5, 6, 60, 61). The lawyers continued to decline to testify (R. 6).

The Commission then filed a complaint against Harrison and Hull in the United States District Court for the District of Columbia (R. 6). The complaint (R. 18-22) recited the nature of the investigation, the Commission's conclusion as to the facts, the direction by the presiding officer and the refusal of the witnesses to answer, and it prayed for an order directing them to appear before the Commission to answer the questions. Otis and Eaton were permitted to intervene (R. 36). The action was heard by Judge Morris on July 19, 20, and 21, 1948. The Commission offered the entire record of its public investigation in support of its complaint (R. 37). Thereafter the cause was extensively briefed, and was decided by Judge Morris on October 18, 1948 in a memorandum (R. 34-45) which was later designated as his findings of fact and conclusions of law (R. 45). On the basic issue he found that the circumstances proved would not "reasonably justify a verdict of wrong-doing which could be sustained, and I, therefore, must conclude that the requisite *prima facie* showing of fraud * * * has not been made", and that therefore the relief prayed for by the Commission must be denied (R. 43, 45). Judgment was entered accordingly (R. 45-46). No appeal was taken, and the judgment has become final.

Although the Commission was and is free to pursue its investigation further, there have been no hearings since the record was submitted to Judge Morris. However, on August 11, 1948, while the action before Judge Morris was being briefed, the Commission began a proceeding against Otis to revoke its broker-dealer registration on the ground that "as the result of a public investigation" the Commission had obtained information which if true showed that

Otis had inspired the Masterson suit. (R. 6, 7, 23-29)[1] This was done despite the fact that just a few weeks earlier the SEC had assured Judge Morris that it needed the testimony of Harrison and Hull to determine whether it should commence such a proceeding (R. 9, 63).

The SEC refused Otis' request to postpone hearings pending decision by Judge Morris in the action which the SEC had itself brought and which had already been heard. An injunction pending that decision was granted by Judge Letts in the absence of Judge Morris (R. 31-32). However, on the very day that judgment was entered in that action by Judge Morris, and despite the character of that judgment, the SEC directed that hearings proceed under its order of August 11 (R. 8, 47-48). The present action was then commenced to enjoin that proceeding on the ground that the question proposed to be tried had already been adjudicated against petitioners; that the Commission had no evidence additional to that which it had presented in its own action; and that prosecution of the proceeding would cause respondent irreparable injury (R. 8-10). An injunction *pendente lite* was applied for (R. 48, 49).

The SEC did not answer the allegations of the complaint and the affidavits. Instead, it moved to dismiss the complaint on the ground that the court did not have jurisdiction of the subject-matter and that the complaint failed to state a cause of action (R. 58). The district court dismissed the complaint (R. 67, 68), but was reversed by the Court of Appeals in a unanimous opinion (R. 72-86). The relief to which respondent was held entitled is set forth in the last paragraph of the petition, as follows (R. 86):

> "The order dismissing the complaint will be set aside and the cause will be remanded. The appellee [SEC] will then have an opportunity to answer and to deny

[1] There were other charges, but they are not involved in the present action because no relief was sought against them. The SEC has chosen not to sever these charges or to hear them separately.

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the allegation that no additional evidence concerning Eaton's collusion will be introduced at its new hearing, and so be relieved of the bar of res judicata."

REASONS FOR DENYING THE WRIT

The two questions which petitioners seek to present to this Court are whether the judgment in the prior SEC action had any binding effect as between the parties thereto, and, if so, whether the court below was nevertheless without jurisdiction to grant the relief set out in the quoted passage.

These questions are neither novel nor important. The attempt to make them appear otherwise is based on inapplicable decisions, and on elaborate hypothetical situations. The decision of the court below is merely that petitioners may not, without additional evidence, retry before themselves a simple issue of fact adjudicated against them in a forum of their own choosing. That decision is a plain application of settled legal principles uniformly adhered to by this Court, does not affect any legitimate administrative function, and has little prospect of future application. Review by this Court is not required in the public interest, and prolongation of the controversy would cause respondent incalculable and unjustified harm.

I. The Commission is Simply Endeavoring to Retry Before Itself, Without Additional Evidence, an Issue Finally Decided Against It in the Courts.

The prior SEC action to enforce its subpoenas against Harrison and Hull was a plenary action in which the judgment is "conclusive upon the parties until reversed" (*Interstate Commerce Commission* v. *Brimson*, 154 U. S. 447, 487). That petitioners had their day in court appears from the recitals of that judgment, which petitioners themselves approved as to form (R. 45).

The court in that action found and concluded as follows (R. 43):

> "It is insisted that inferences should be drawn from the evidence that Eaton, through the defendants and others, inspired and induced the filing of the Masterson suit . . . I do not consider the circumstances here proved to be such, *without more*, as to reasonably justify a verdict of wrongdoing which could be sustained and I, therefore, must conclude that the requisite prima facie showing of fraud . . . has not been made . . ."

The record here is plain that petitioners in fact seek "without more" to relitigate the issue of whether respondent induced the filing of the Masterson suit. Not only must this allegation be accepted as true for purposes of the motion to dismiss, but the petition concedes, albeit cautiously, that such in fact is the case, stating (Pet. 19, n. 9):

> "While the petitioners have not yet answered the allegation that there is no 'new evidence' and while they do not mean to imply that they will admit that allegation, it may be inferred from the history of this proceeding that the petitioners know of no startling piece of 'new evidence' whose production in the District Court would result in a final judgment for them under the decision below, and hence render academic the question raised by this petition."[2]

This concession was not made in the court below, but petitioner's position was made clear by their insistence that they should be permitted to proceed with their hearing be-

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[2] Petitioners appear to be offended at the requirement that, like other unsuccessful litigants, they make a showing of new evidence in support of a second trial. Other agencies have not hesitated to do so, e.g., the National Labor Relations Board in *International Union of Mine, Mill & Smelter Workers* v. *Eagle-Picher Mining & Smelting Co.*, 325 U. S. 335. The requirement is not burdensome, since only the *prima facie* character of the new evidence is involved. The suggestion that petitioners will have to submit to examination is fanciful, and the grievance would appear to be academic in view of the concession.

cause the same evidence, even though it failed to show a *prima facie* case of wrongdoing, might nevertheless be sufficient to avoid reversal under the substantial evidence rule.[3] The petition now purports to abandon this argument[4] but it does not suggest any other reason why petitioners wish to conduct their administrative hearing when their entire evidence is insufficient to constitute even a *prima facie* case of misconduct. Yet the right to conduct such a hearing is the maximum relief which petitioners seek from this Court, since, if they find additional evidence, they are free to proceed under the decision of the court below.

II. The Decision Below is an Ordinary Application of the Principles of Res Judicata.

It is settled beyond dispute that the Government as a litigant is entitled to the benefits of adjudications in its favor and is bound by adjudications adverse to it (*Southern Pacific Railway Co.* v. *U. S.*, 168 U. S. 1; *Sealfon* v. *U. S.*, 332 U. S. 575). The rule is the same where the Government is represented by an administrative agency (*Sunshine Anthracite Coal Company* v. *Adkins*, 310 U. S. 381; *Tait* v. *Western Maryland Railway Company*, 289 U. S. 620; *International Union of Mine, Mill & Smelter Workers* v. *Eagle-Picher Mining and Smelting Co.*, 325 U. S. 335; *George H. Lee Company* v. *Federal Trade Commission*, 113 F. (2d) 583 (C. A. 8, 1940); *United States* v. *Willard Tablet Co.*, 141 F. (2d) 141 (C. A. 7, 1944).

The last two cases, which did not reach this Court, require comment for that very reason. In the *Lee* case, a judgment for defendant in an action by a United States Attorney under the pure food laws was held to bar trial of the same fact issue by the Federal Trade Commission

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[3] This argument was the cause of the discussion by the Court of Appeals of the nature of substantial evidence (R. 83-86), now criticized in the petition (Pet. 15, n. 6).

[4] Ib.

under the laws administered by it. In the *Willard Tablet* case the situation was reversed. Both are more dramatic instances of res judicata than the case at bar. But in neither was certiorari sought by the Government, presumably because the law was too well-settled to warrant seeking review by this Court.

In their effort to justify review in *this* case, petitioners seek to create issues where none exist. Their principal contention appears to be that a judgment in a subpoena-enforcement action is not entitled to the same force as other judgments. This is in the teeth of overwhelming authority. The prior subpoena-enforcement action was an ordinary civil action governed by the Federal Rules of Civil Procedure (Rule 81-a-3). It began with a complaint, proceeded with the reception of evidence, next with findings of fact and conclusions of law (as required by Rule 52 in actions tried by the court without a jury) and ended in a judgment, which was, even before the Federal Rules, subject to appeal "as much as an independent suit in equity" (*Cobbledick* v. *U. S.*, 309 U. S. 330).

Petitioners say that judgment in such an action is "ancillary" or "auxiliary" or "preliminary". But this Court has said exactly the contrary: " • • • that determination *will not be merely ancillary and advisory*, but, • • • will be 'a final and indisputable basis of action' as between the Commission and the defendants, and will furnish a precedent in all similar cases." (*Interstate Commerce Commission* v. *Brimson*, 154 U. S. 447, 487; *accord: Interstate Commerce Commission* v. *Baird*, 194 U. S. 25; *Federal Trade Commission* v. *Claire Furnace Company*, 274 U. S. 160; *Cobbledick* v. *U. S.*, 309 U. S. 323).

Similarly, petitioners' effort to analogize the situation here to certain preliminary proceedings in criminal cases is refuted by the very authorities cited. Thus, in the language of this Court in *United States ex rel. Rutz* v. *Levy*, 268 U. S. 390, 393, such proceedings "are not a trial in any sense". Cf. *Todd* v. *United States*, 158 U. S. 278. In

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marked contrast, the previous subpoena-enforcement action in this case was a trial in every sense.[5]

Petitioners also urge that this Court should deny binding effect to adjudications in subpoena-enforcement actions on the ground of necessity. They argue that otherwise subpoena-enforcement actions may become traps for unwary administrators and result in frequent trials by the courts of issues which ought properly to be tried before the agencies themselves.

The picture is, to say the least, overdrawn. The Court will no doubt take judicial notice of the able legal representation of the federal agencies. But even without such representation, the imagined consequences would not follow. A subpoena-enforcement action, like any other action, can only be a bar as to matters alleged and decided. In the ordinary subpoena-enforcement action, the sole function of the court is to determine the general authority of the administrative agency to conduct the inquiry, and no showing of "probable cause" by the agency is required (*Oklahoma Press Publishing Co.* v. *Walling*, 327 U. S. 186).

The instant case is, so far as counsel can discover, the only subpoena-enforcement action in which it was necessary to try an issue of fact. Although it is possible that other cases involving issues of fact may arise in the future, it is plain from the inherent circumstances that they will be rare indeed. If an issue is tried in the exceptional case—of which this is the only one thus far—there is no reason whatever why it should be retried in another forum.[6]

There is nothing to the contrary in *Myers* v. *Bethlehem Shipbuilding Corporation*, 303 U. S. 41, and related cases, nor in the concept of primary jurisdiction (Petition 10-15).

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[5] In criminal cases also, independent proceedings which result in appealable orders are likewise *res judicata*. *Steele* v. *United States*, 267 U. S. 505. *Cf. Cogen* v. *United States*, 278 U. S. 221.

[6] The same rule has applied in other cases of "exclusive" jurisdiction, e.g., bankruptcy. Cf. *Pepper* v. *Litton*, 308 U. S. 295 with *Heiser* v. *Woodruff*, 327 U. S. 726.

The *Myers* doctrine condemns attempts to compel administrative agencies to try in the courts issues the trial of which in the first instance has been committed to the agencies. But the case at bar does not involve trial of an issue in the first instance. That trial has already been had. To be sure it took place in the district court rather than before the Commission, but this was done on the Commission's own complaint, filed pursuant to express statutory authority. In trying that issue the district court was not interfering with the Commission's prerogatives; it was merely discharging a duty which the Commission itself thrust upon it.

Important questions involving administrative agencies are not infrequently settled in actions in which the agencies have not acted as the tribunal. A recent instance is *Federal Power Commission* v. *Panhandle Eastern Pipe Line Company* (— U. S. —; decided June 20, 1949). The contention that an agency should be free to retry before itself an issue so tried and adjudicated, finds no support in the *Myers* case or elsewhere, and does not warrant review by this Court.

III. Injunctive Relief is the Standard Remedy for Attempts to Relitigate Issues Already Decided.

It is well settled that a court which has decided an issue will enjoin a subsequent attempt to relitigate that issue. (*Root* v. *Woolworth*, 150 U. S. 401, 411-14; *Kessler* v. *Eldred*, 206 U. S. 285; *American Brake Shoe & Foundry Company* v. *Interborough Rapid Transit Co.*, 136 F. (2d) 681 (C. A. 2, 1943) cert. den., 320 U. S. 756, 794). As the court said in *Root* v. *Woolworth*, supra:

> "The jurisdiction of courts of equity to interfere and effectuate their own decrees by injunctions or writs of assistance, in order to avoid the relitigation of questions once settled between the same parties, is well settled."

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Here, again, petitioners ask this Court to carve out an exception for this case, on the ground that injunctive relief is an undue interference with the administrative process in violation of the *Myers* and similar cases. Such an exception is not supported by anything considered in those cases, and it is in direct conflict with the principle expressed by this Court in *International Union* v. *Eagle-Picher Mining & Smelting Co., supra,* that "Finality to litigation is an end to be desired as well in proceedings to which an administrative body is a party as in exclusively private litigation. The party adverse to the administrative body is entitled to rely on the conclusiveness of a decree entered by a court to the same extent that other litigants may rely on judgments for or against them." A similar plea, in reliance upon the same cases, was recently rejected (*Federal Power Commission* v. *Panhandle Eastern Pipe Line Company, supra*).

The suggestion that res judicata can be pleaded before the agency is not novel. In every case where relitigation has been enjoined res judicata could have been pleaded before the second tribunal. But it is the tribunal familiar with the controversy and whose decree is to be respected which is the proper one to grant relief.[7] A basic objective of the doctrine of res judicata would be frustrated if relief can be obtained only after suffering the full injury of a second trial. As this Court stated long ago in *United States* v. *Throckmorton,* 98 U. S. 61, 65:

> "There are no maxims of the law more firmly established or of more value in the administration of justice than the two which are designed to prevent repeated litigation between the same parties in regard to the same subject of controversy, namely: 'interest reipub-

[7] Recent legislative action to the same effect, in amending former Sec. 265 of the Judicial Code, is discussed in the opinion of the Court of Appeals (R. 79, n. 3).

licae, ut sit finis litium, and Nemo bis vexari pro una et eadam causa'."[8]

Adherence by the court below to these principles surely does not call for the intercession of this Court.

CONCLUSION.

For the foregoing reasons the petition for certiorari should be denied.

Respectfully submitted,

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September, 1949.

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[8] Cf. *George H. Lee Co.* v. *Federal Trade Commission, supra,* (113 F. (2) at 586):

> "Unless a question which a court or an administrative board has power to decide is to be regarded as conclusively settled as between the parties by the final decree of the court or the final order of the board, there can be no end to a controversy except as the result of the financial disability of one of the parties."

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No. 244

SECURITIES AND EXCHANGE COMMISSION, EDMOND M. HANRAHAN, RICHARD B. MCENTIRE, HARRY A. MCDONALD and PAUL R. ROWEN, *Petitioners,*

v.

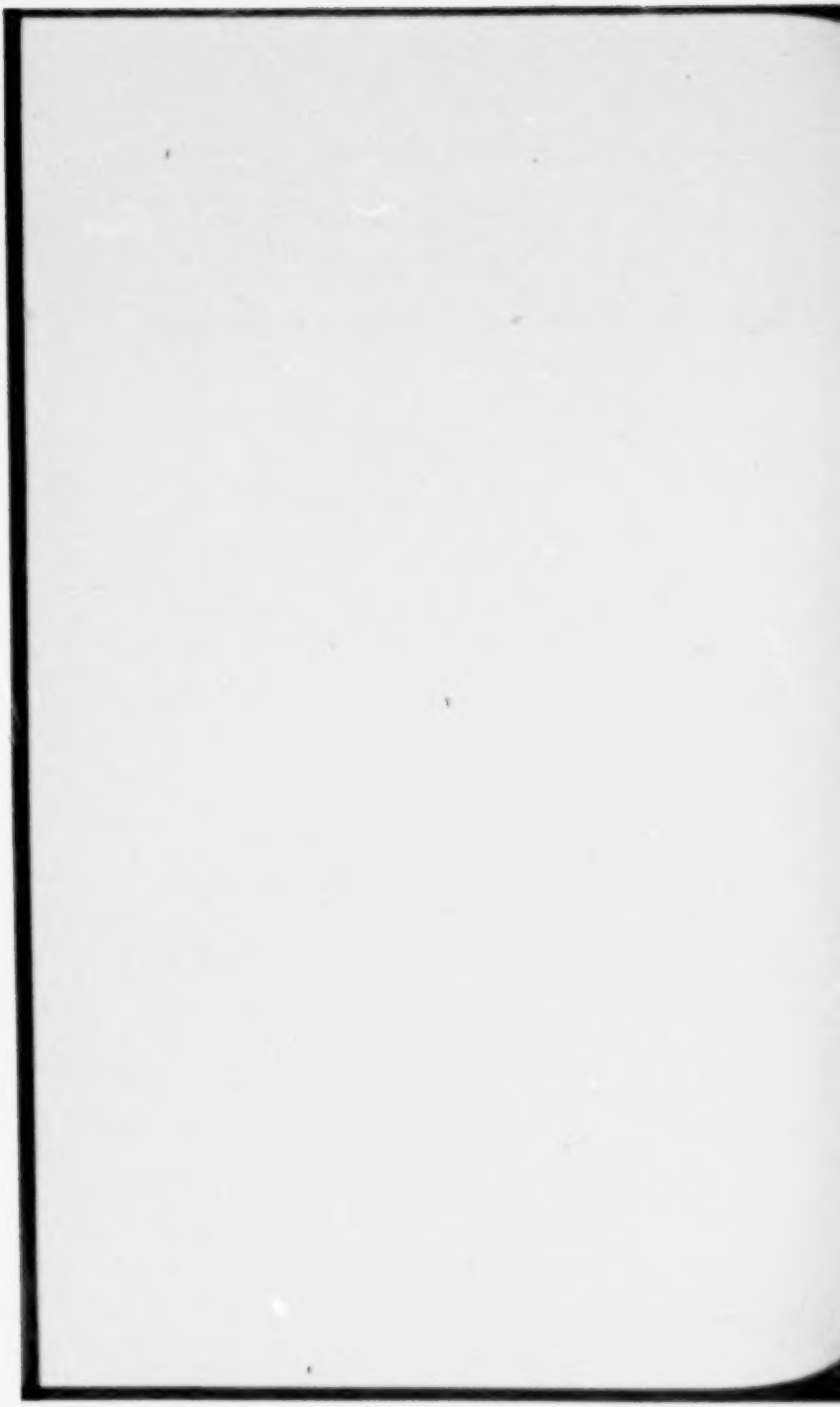
OTIS & CO., *Respondent.*

PETITION FOR RECONSIDERATION.

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IN THE

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OCTOBER TERM, 1949.

No. 244

SECURITIES AND EXCHANGE COMMISSION, EDMOND M. HANRAHAN, RICHARD B. MCENTIRE, HARRY A. MCDONALD and PAUL R. ROWEN, *Petitioners,*

v.

OTIS & CO., *Respondent.*

PETITION FOR RECONSIDERATION.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Respondent, Otis & Co., respectfully requests the reconsideration by the Court of its action in reversing the judgment of the Court of Appeals in this matter without oral argument and without briefs on the merits, and respectfully requests that the matter be set down for argument in this Court and that the filing of briefs be permitted in the normal course.

Otis & Co. by the summary action of the Court has been deprived of any opportunity to argue to this Court the

merits of its position on the issue thus decided by this Court.

The rules of the Court (Rule 38, paragraph 5) specifically point to the considerations which must be stressed in petitioning for certiorari and consequently in opposing the grant of certiorari. These criteria make it clear that the question of grant or denial of certiorari is based on considerations independent of the merits of the particular action. See *House* v. *Mayo*, 324 U. S. 42, 48: "But as we have often said a denial of certiorari by this Court imports no expression of opinion upon the merits of a case. . . ." See also *United States* v. *Rimer*, 220 U. S. 547, and *Layne & Bowler Corp.* v. *Western Well Works*, 261 U. S. 387, holding that where on argument it appears that the issue is not of public importance, it is the court's "duty . . . not to pass upon the merits of the case, but to dismiss the writ . . ." (220 U. S. 547, 548). Both the latter cases are cited in paragraph 2 of Rule 38 of the Rules of this Court.

The Court has itself stated that it cannot critically examine the many records presented to it and "must rely very largely upon preliminary papers." *Southern Power Co.* v. *North Carolina Public Service Co.*, 263 U. S. 508, cited in paragraph 2 of Rule 38 of this Court. The Court has advised that in the light of its heavy docket and need for prompt attention, petitions should be accurate, *brief* and clear. *Furness, Withy & Co.* v. *Yang Tsze Insurance Assn.*, 242 U. S. 430, cited in paragraph 2 of Rule 38.

The petition of the government in this case consequently stressed not the merits of the issue but merely argued that "a novel and important question" was raised (Petition p. 10). In reply our opposition brief was a mere twelve pages, and argued that the questions were "neither novel nor important" and that the case was a unique one having "little prospect of future application." (Brief, p. 5.) Neither party presented the merits of its argument, except incidentally. Both understood that if the Court regarded the question as not important, argument on the merits would

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be unnecessary and that if the Court regarded the question as involving a matter of consequence, both sides would then have adequate opportunity to be heard on the merits.

In *FCC* v. *WJR*, ... U. S. ...., 69 S. Ct. 1097, decided June 6, 1949, the Court held that oral argument was not a necessary element of due process. But it clearly indicated that the agency must grant the parties an "opportunity to present for . . . consideration any matter of fact or law in connection with its application . . ." And the Court held that where the parties had adequate notice of the issue before the Commission and could direct written argument to that issue on the merits, due process of law had been observed.

On the contrary, counsel in the present case, pursuant to the policy suggested by the rules of this Court, refrained from directing argument to the merits. This was done in an effort to aid the Court in deciding whether it should exercise its discretion to grant or deny review by the criteria set forth in its Rules. In such a case, it seems both unfair and not in accordance with traditions of due process to decide the case without permitting some opportunity to respondent to present its argument on the merits.

This is especially true where the government in its petition has not asked for reversal as well as the grant of certiorari. Had it done so respondent would have been on notice of the possibility of final disposition and would have had an opportunity to direct argument not only to the request for certiorari but also to the request for reversal. But where no request is made by any party for a decision on the merits and no briefs are presented on the merits, the respondent had been deprived of the opportunity to direct the attention of this Court to the reasons why the judgment below should be sustained on the merits.

We appreciate that this Court has a busy calendar but the issues of these cases are of substantial consequence to the private parties who litigate with the government. They may mean the difference between economic life and death.

The decision of this Court, as we did not believe it appropriate to show in our petition, would cause incalculable harm to Otis & Co. We did not point this out because this Court has stated that in deciding whether to grant certiorari, it is concerned only with issues of "importance to the public, as distinguished from that of the parties . . ." *Layne & Bowler Corp.* v. *Western Well Works*, 261 U. S. 387, 393, per Taft, C.J. Because of our belief in the limited nature of this Court's considerations on the issue of certiorari, we did not point out that the position urged by the SEC here involved an unwarranted extension of the *Myers* case. We were prepared to show on the merits that it was such an extension and that in the alternative if the *Myers* case was as broad as the government contended, that the time had come when the doctrine should be limited against abuse.

We further intended to show that the new Judicial Code, § 2283 shows a clear congressional intention that relitigation of decided issues should be enjoined. (This section of the Judicial Code reversed the decision of this Court in *Toucey* v. *New York Life Insurance Company*, 314 U. S. 118. See Reviser's Note to § 2283.) We also intended to show that Congress in the Administrative Procedure Act, 5 USC § 1001 et seq. indicated that abuses such as relitigation were no more to be tolerated in administrative agencies than in the courts. We intended to show the abuse, the injury and the intolerable burden of oppression which would result in the present case from permitting relitigation of issues already concluded. We intended to show the evil that would follow from remitting us to a hearing before the SEC, to years of litigation and expense, perhaps only at the end to face again in this Court the *res judicata* question, which the Court did not pass on in its summary reversal. Only then perhaps shall we know whether the entire proceedings taken in the interim have been a waste of time and energy of the private parties and of the government repeating the grave injustice involved in the lengthy and

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useless Federal Trade Commission proceedings in the *Lee* case. (*George H. Lee Co.* v. *F.T.C.*, 113 F. (2d) 583 (CCA 8, 1940)).

In addition, we wish to point out that, if the procedure adopted in this case is followed, no respondent's counsel will feel safe in filing the kind of short opposition brief filed in this case, but will, in justice to his clients, be required to argue the merits at length. The consequent increase in the size of petitions will involve a more substantial impediment to the speedy conclusion of the work of this Court, than the occasional necessity of hearing argument even where the merits seem clear to the Court from the face of the petition.

Respectfully submitted,

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I hereby certify this petition is filed in good faith and not for purpose of delay.

.....

No. 244. SECURITIES & EXCHANGE COMMISSION ET AL. *v.* OTIS & Co. On petition for writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit. *Per Curiam:* The petition for writ of certiorari is granted and the judgment is reversed. *Myers* v. *Bethlehem Shipbuilding Corp.*, 303 U. S. 41; *Macauley* v. *Waterman S. S. Corp.*, 327 U. S. 540; *Federal Power Comm'n* v. *Arkansas Power Co.*, 330 U. S. 802. MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case. *Solicitor General Perlman* and *Roger S. Foster* for petitioners. *Joseph L. Weiner* for respondent. Reported below: 85 U. S. App. D. C. 122, 176 F. 2d 34.